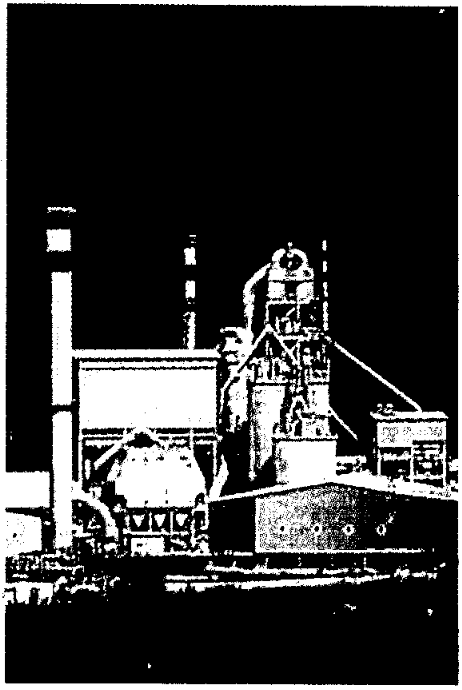
LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

Edited by
Bambang Sindu Wahyudi



THE SEACEN CENTRE

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

Edited by

Bambang Sindu Wahyudi

The South East Asian Central Banks (SEACEN)
Research and Training Centre
Kuala Lumpur, Malaysia

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

© 1994 The SEACEN Centre

Published by The South East Asian Central Banks (SEACEN)
Research and Training Centre
Lorong Universiti A,
59100 Kuala Lumpur, Malaysia.
Tel No: 03-7585600
Fax No: 603-7574616
Telex: MA 30201
Cable: SEACEN KUALA LUMPUR

ISBN: 983-9553-48-8

All rights reserved. No part of this publication
may be reproduced, stored in a retrieval system,
or transmitted in any form by any system, electronic,
mechanical, photocopying, recording or otherwise,
without the prior permission of the copyright holder.

Printed in Malaysia by Graphic Stationers Sdn. Bhd.

FOREWORD

Manufacturing and agricultural sectors are by far the most important sectors and will continue to play a significant role in the economic development of the SEACEN countries in the decade ahead. The interrelationships between the growth in manufacturing and agricultural sectors are critical for the overall economic growth, since those industries are fully complementary to each other. In particular, these two sectors will be the engine for economic growth as well as structural adjustment in the economy. The rapid growth and development of the manufacturing and agricultural industries in the SEACEN countries have influenced the role played by commercial banks and non-bank financial institutions in rendering financial services. Long-term financing for these two key sectors can, therefore, be regarded as one of the important instruments of economic policy of the SEACEN countries in their efforts to stimulate development in a direction considered desirable on economic and social grounds.

This paper is an attempt to study the experience of the SEACEN countries in their involvement with long-term financing for manufacturing and agriculture, the role played by the central bank in supporting these important fields and to consider what changes are required for the improvements on the current financing programmes.

The research project is a collaborative effort between the member central banks and The SEACEN Centre. Seven member banks participated in this project, namely Bank Indonesia, The Bank of Korea, Bank Negara Malaysia, Nepal Rastra Bank, Bangko Sentral ng Pilipinas, Central Bank of Sri Lanka and the Bank of Thailand. Each participating researcher from a member central bank prepared the respective country chapters which form the contents of Part II. In this regard, The SEACEN Centre wishes to express its sincere gratitude to the participating member central banks for their strong support and contributions for the successful implementation of this project.

This collaborative research project was undertaken by Dr. Bambang S. Wahyudi, Assistant Director for Research seconded from Bank Indonesia. He is responsible for the research design and the coordination among the participating researchers. He also authored Part I of the study. At various stages of the project, Dr. Bambang was assisted by Mrs. Jami'ah Jaffar, Senior Research Associate, who took charge of the data collection, compilation, data transformation and provided the

necessary research support. The manuscript was typed by Mrs. Haslina Muda, Senior Clerical Officer of the Administrative Unit.

The views expressed in this volume, however, are those of the authors and should not in any manner be ascribed to the institutions or individuals whose assistance is duly acknowledged herein.

Dr. Vicente B. Valdepeñas, Jr.
Director
The SEACEN Centre

Kuala Lumpur, Malaysia
November 1994

EXECUTIVE SUMMARY

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

The collaborative research project on Long-term Financing for Manufacturing and Agricultural Sectors in the SEACEN Countries was a joint effort between the member central banks and The SEACEN Centre. Country researchers from seven member banks participated in this project, namely Bank Indonesia, The Bank of Korea, Bank Negara Malaysia, Nepal Rastra Bank, Bangko Sentral ng Pilipinas, Central Bank of Sri Lanka and the Bank of Thailand.

The study is a comparative analysis of the way government policies and regulatory practices affect the performance of long-term financing for manufacturing and agricultural sectors in the SEACEN countries. The study also identifies policies and regulations which make the financing for these two sectors more adaptable, efficient and effective. It also evaluates the appropriate role of the central bank at participating in the provision of long-term financing for these two sectors and the implications arising from their participation.

This research project, though qualitative in nature, is supported by major statistical evidence such as data on shares of manufacturing and agriculture in the country's Gross Domestic Product; average ratio of total long-term financing for agriculture and manufacturing to Gross Domestic Product, exports, value added and total loans; employment in agricultural and manufacturing sectors; and growth of long-term financing for agriculture and manufacturing.

It is observed that long-term financing for manufacturing and agricultural sectors are urgently needed by all SEACEN countries, as the stages of their respective economic developments are either still early or well into a transition. The economic development policy of the country also determines the needs for these financing. Some countries are now putting more efforts on their manufacturing industries as their development policies are moving toward industrialization, whereas some other countries are still concentrating on developing their agricultural sector.

In comparing the needs between the long-term financing for the manufacturing and agricultural sectors, it is found that, with the exception of Malaysia, long-term financing requirements for the manufacturing sector in Indonesia, Korea, the Philippines, Nepal and Sri Lanka are greater than those for the agricultural sector. While for Thailand long-term financing is equally needed for both sectors. This is an indication that at this stage, the majority of the SEACEN countries are now giving more efforts at developing their manufacturing industries. This finding is supported by evidence on the growth rate of employment in the two sectors, where for the majority of the SEACEN countries the growth rate of employment in the manufacturing sector is much higher than that of the agricultural sector. The observations are further supported by the fact that, in 1993, the contribution of the manufacturing sector to the formation of their Gross Domestic Product in almost all SEACEN countries is higher than that of the agricultural sector.

It is observed that in all the SEACEN countries, bank loan supervision is needed in order to reduce the risk of bank loan failure and to ensure that banking operations are soundly and efficiently conducted. With the exception of Indonesia, where the central bank has special departments that conduct indirect and direct supervision on the bank loans, the supervision of the bank loans by most SEACEN central banks is done under their general supervision on the overall business of the operating banks. In general, the involvement of the central banks in the long-term loan business is confined to providing or channeling funds through financial or non-financial institutions.

By way of recommendations for further improvements of long-term financing for the manufacturing and agricultural sectors, these stress mainly the factors limiting access to credits, repayment problems and future demand for credit.

TABLE OF CONTENTS

Page

PART II

COUNTRY STUDIES

Chapter 6

Page

Chapter 7

Page

Chapter 8

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN MALAYSIA 133

Page

Page

Page

Chapter 12

Page

LIST OF TABLES

Table		Page

Table		Page

Table		Page
8.2	Ratio of Long-Term Financing for the Manufacturing and Agricultural Sectors to GDP, Total Exports and Value Added	141
8.3	Contribution of Agricultural and Manufacturing Sectors to Employment	142
8.4	Contribution of Agricultural and Manufacturing Sectors to Exports	143
8.5	Long-Term Financing for the Manufacturing Sector by Product	145
8.6	Main Export and Import Commodities	147
8.7	Long-Term Financing for the Agriculture Sector by Product	148
8.8	Amount of Leasing Contracts	151
8.9	Long-Term Financing to the Agricultural and Manufacturing Sectors by Institutions (As at end of 1980)	152
8.9a	Long-Term Financing to the Agricultural and Manufacturing Sectors by Institutions (As at end of 1985)	152
8.9b	Long-Term Financing to the Agricultural and Manufacturing Sectors by Institutions (As at end of 1990)	152
8.10	Sources of Funds of the Industrial Finance Institutions	153
8.11	Sources of Funds of the Banking System	154
8.12	Sources of Funds of the Agricultural Credit Institutions	155
8.13	Principal Support System of the Central Bank of Malaysia for Long-Term Financing	157

Table		Page

Table		Page

Table		Page

Table		Page

Table		Page

LIST OF CHARTS

LIST OF APPENDICES

Part I

REGIONAL OVERVIEW:

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

PART 1 - REGIONAL OVERVIEW

Chapter 1

LONG TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

by
Bambang Sindu Wahyudi

I. Introduction

Manufacturing and agricultural sectors are by far the most important sectors in the economy of the SEACEN countries and will continue to play a significant role in the decade ahead. As usually happens in any developing countries, the interrelationships between the growth in manufacturing and agricultural sectors are critical for overall economic development, since those industries are fully complementary to each other. If agriculture is to stimulate a higher standard of living, then manufacturing must be developed. Equally, if manufacturing is to be developed, then higher agricultural productivity and farm incomes must lead to a higher standard of living, in order to provide a higher demand for manufactures. They thus reinforce each other. In particular, these two sectors will be the twin engine for economic growth as well as structural adjustment in the economy.

The rapid growth and development of manufacturing and agricultural industries in the SEACEN countries have influenced the role played by commercial banks and non-bank financial institutions in rendering financial services, further creating a more competitive environment in the financial system. Long-term financing is required by manufacturing and agricultural industries to purchase land, construct buildings and acquire machinery and equipment. In certain cases, such loans may also be needed to purchase new and appropriate technologies. Long-term financing for these two key sectors can, therefore, be regarded as one of the important instruments of economic policy for the SEACEN countries in their efforts to stimulate development in a direction considered desirable on economic and social grounds. Not only can long-term financing remove financial constraint, but it may also accelerate the adoption of new technologies.

1.1 Significance of the Study

Most of the SEACEN countries are now placing the emphasis in their economy on industrialization, with manufacturing and agricultural sectors providing the main impetus for economic growth. Except in Korea, the Philippines and Thailand where the manufacturing sector has been historically stronger than the agricultural sector, by 1993 the manufacturing sector of Indonesia and Malaysia had overtaken the agricultural sector as the main contributor to their economic growth. In comparison, the economies of Nepal and Sri Lanka continue to depend heavily on agriculture.

Development and the modernization of the manufacturing and agricultural sectors depend to a large extent on credit facilities provided by the financial institutions. Appropriate incentives and ready access to institutional credit must be given to these sectors in order to ensure their continued development and viability. Although credit is only one of the financial inputs, it is one of the more important ingredients in attaining the objectives for development. With the rapid increase in the manufacturing and agricultural sectors of the SEACEN countries up to the present, the need to finance both of these sectors in the future will become more pressing. Moreover, the rapidly increasing use of credit in manufacturing and agriculture sectors will need more attention on problems faced by financial institutions in their efforts to finance the industries. Although progress has been achieved towards improving manufacturing and agricultural financing, some factors still hamper the efficient flow of credit resources to these sectors. Difficulties associated with the demand and use of credit are common deterrents to the success of the credit machinery. Particularly in the field of agricultural credit, for instance, the unwillingness of most financial institutions to enter this field because of chronically high risk and low yield of agricultural loans hamper the supply of funds. The lack of coordination with the other elements of the development program may also be one of the reasons why a financing program performs below expectations. Therefore, the role of the financial institutions in providing funds to these two sectors should be examined. Recent performance in economic developments of the SEACEN countries increases rather than reduces the importance of issues related to financing these sectors.

1.2 Objectives of the Study

The basic objectives of this research project are as follows: (i) to analyze the sources of long-term financing for manufacturing and agricultural sectors; (ii) to compare and contrast the strategies and methods of financing (direct finance and financial intermediation); and, (iii) to ascertain the appropriate role of central banks in financing these two sectors.

1.3 Scope of the Study

This research project attempts to study the experience of the SEACEN countries in their involvement with long-term financing of manufacturing and agriculture; the role played in the past by the central bank or monetary authority in these important fields; and, to consider what changes are required for improvements over the existing financing. It covers only seven participating SEACEN member countries, namely, Indonesia, Korea, Malaysia, Nepal, the Philippines, Sri Lanka and Thailand.

1.4 Research Design

This study has been approved by the Board of Governors of the SEACEN countries as a *Collaborative Research Project.* It emphasizes the comparative analysis of the way government policies and regulatory practices affect the performance of long-term financing for manufacturing and agricultural sectors in the SEACEN countries, with a view to drawing useful lessons out of the experiences of the countries in the region. Further, the study identifies policies and regulations that make the financing in these sectors adaptable, efficient, and effective. It also discusses the appropriate role of the central bank at participating in the provision of long-term financing for these two key sectors and the implications arising from their participation.

The study is in two parts. Part I is an overview and summary of the individual country studies and presents a comparative and regional analysis based on the data provided by the country chapters, while Part II consists of the country chapters contributed by country researchers from the respective member central banks participating in the study.

Chapter 2

AN OVERVIEW OF CURRENT CONDITIONS OF LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE SEACEN COUNTRIES

I. Nature of Long-Term Financing for Manufacturing and Agricultural Sectors

The economies of seven SEACEN member countries under study have been dominated so far by manufacturing and agriculture. These two key sectors are, in particular, the twin engine for their economic growth and will continue to play a significant role in the decade ahead. As expressed in the relative contribution to the respective countries' GDP during the period 1979 - 1993 (Table 2.1) the agricultural sector as a share of real GDP which in the past was a very large part for Indonesia and Malaysia had been overtaken in 1993 by the manufacturing sector. The share of the manufacturing in 1993 for Indonesia and Malaysia rose to 21.00 per cent and 30.00 per cent respectively, as against the share of the agricultural sector of 17.50 per cent and 15.90 per cent respectively. For Korea, the Philippines, and Thailand, their manufacturing sectors historically have been the main contributor to their GDP. In 1993, the relative shares of the manufacturing sector in Korea, the Philippines and Thailand were 29.00 per cent, 24.80 per cent and 30.70 per cent respectively, as compared to 7.50 per cent, 22.70 per cent and 11.80 per cent respectively for the share of the respective agricultural sectors. In comparison, the economies of Nepal and Sri Lanka are still heavily dependent on agriculture, although the share of their respective manufacturing sectors tends to increase from year to year. In 1993, the relative shares of manufacturing sectors for Nepal and Sri Lanka were 8.40 per cent and 19.10 per cent respectively, as against 49.30 per cent and 30.90 per cent respectively for their respective agricultural sectors (Table 2.1). By way of looking at the average trend of manufacturing across the seven countries over the period 1989 - 1993, it is evident that the economic structure of Korea is relatively the most industrialized (30.01 per cent), followed by Thailand (28.14 per cent), Malaysia (27.82 per cent) and the Philippines (25.33 per cent). In comparison, Nepal is the only country among the SEACEN countries which remains to rely heavily on its agriculture (53.22 per cent).

For SEACEN countries, long-term financing can be regarded as one of their important policy instruments for the national economy.

Financing is used not only to purchase lands, buildings or machineries, but also to stimulate development in a direction considered desirable on economic and social grounds. Interesting development of the long-term financing for the manufacturing agricultural sectors in each

Table 2.1

SHARES OF MANUFACTURING AND AGRICULTURE AS COMPONENT OF GDP AT CONSTANT PRICE

(In Per Cent)

Country	1979	1 984	1989	1990	1991	1992	1993	Avg.89-93
Manufacturing:								
Indonesia	11.56	14.55	18.45	19.40	19.80	20.50	21.00	19.83
Korea*/	26.34	30.29	33.65	29.20	29.10	29.10	29.00	30.01
Malaysia*/	19.32	20.28	25.08	26.90	28.20	28.90	30.00	27.82
Nepal**/	4.01	4.50	4.87	5.60	6.50	7.90	8.40	6.65
Philippines*/	27.86	25.32	25.54	25.60	25.60	25.10	24.80	25.33
Sri Lanka*/	14.37	14.74	16.83	17.40	17.70	18.50	19.10	17.91
Thailand	22.11	21.54	23.91	27.80	28.70	29.60	30.70	28.14
Agriculture:								
Indonesia	24.48	22.29	20.46	19.40	18.40	18.40	17.50	18.83
Korea*/	17.14	13.20	8.95	8.70	8.00	8.10	7.50	8.25
Malaysia*/	29.28	20.13	20.43	18.60	17.10	16.60	15.90	17.73
Nepal**/	57.90	53.87	55.32	55.70	53.70	52.10	49.30	53.22
Philippines*/	23.75	23.22	22.90	22.40	22.80	22.80	22.70	22.72
Sri Lanka*/	24.98	25.01	22.73	23.20	22.60	21.30	30.90	24.15
Thailand	21.24	19.44	16.09	13.60	13.20	12.70	11.80	13.48

*/ Agriculture includes forestry and fishing.
**/ At current market prices.

Sources: *SEACEN Financial Statistics* and *ADB Key Indicators*, various volumes.

individual SEACEN country can be followed by looking through their ratios to the country's GDP, exports, value added and total loans as depicted in Table 2.2. The same ratios but with a further breakdown according to the financing extended for each sector are also provided in Table 2.3. However, given the difference in the definition of long-term financing in terms of their relative maturities across countries and the limitations of the data available for this study, the interpretation of these tables must be done with much caution and care.

Table 2.2

AVERAGE RATIO OF TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GDP, EXPORTS, VALUE ADDED AND TOTAL LOANS

(In Per Cent)

Country	Ratio to GDP	Ratio to Exports	Ratio to Value Added	Ratio to Total Loans
Indonesia 1/ (1979-1989)	3.8	15.9	9.7	15.9
Korea 2/ (1980-1990)	6.4	24.4	16.9	12.1
Malaysia 2/ (1980-1990)	16.1	22.7	37.5	14.3
Nepal 3/ (1981-1990)	4.6	88.6	7.8	34.8
Philippines 4/ (1980-1990)	0.8	4.8	1.5	3.7
Sri Lanka 4/ (1980-1990)	0.9	3.6	2.1	18.9
Thailand 5/ (1985-1990)	0.4	1.6	1.0	0.7

1/ Maturity of over 3 years
2/ Maturity of over 1 year
3/ All Maturities
4/ Maturity of over 5 years
5/ Long-term loans from IFCT and BAAC only, with maturity of over 5 years.

Source: Country papers and *SEACEN Financial Statistics*, various volumes.

Table 2.3

AVERAGE RATIO OF LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GDP, EXPORTS, VALUE ADDED AND TOTAL LOANS

(In Per Cent)

Country	Ratio to GDP		Ratio to Exports		Ratio to Value Added		Ratio to Total Loans	
	LTFA	LTFM	LTFA	LTFM	LTFA	LTFM	LTFA	LTFM
Indonesia 1/ (1979-1989)	1.0	2.8	4.2	11.7	4.1	21.1	3.9	12.0
Korea 2/ (1980-1990)	1.8	4.6	6.0	18.4	14.5	17.8	3.0	9.1
Malaysia 2/ (1980-1990)	10.1	6.0	14.4	8.3	50.1	27.0	9.0	5.3
Nepal 3/ (1981-1990)	1.7	2.9	33.1	55.4	3.1	6.0	13.0	21.8
Philippines (1980-1990)	0.3	0.5	1.7	3.1	1.2	1.9	1.4	2.3
Sri Lanka 4/ (1980-1990)	0.2	0.7	0.7	2.9	0.7	4.0	3.8	15.1
Thailand 5/ (1985-1990)	0.2	0.2	0.8	0.8	1.3	0.8	0.4	0.3

1/ Maturity of over 3 years
2/ Maturity of over 1 year
3/ All Maturities
4/ Maturity of over 5 years
5/ Long-term loans from IFCT and BAAC only, with maturity of over 5 years.

Sources: Country papers and ***SEACEN Financial Statistics,*** various volumes.

In the area of total long-term loans extended to the agricultural and manufacturing sectors in the SEACEN countries as measured by their corresponding ratio to GDP, the figures show that activities in long-term lending to these two sectors in Malaysia were very pronounced among the SEACEN countries, highlighting the banking sectors efforts at promoting new capital investments in the agricultural and manufacturing sectors in this country through the provision of long-term loans. This is followed by Korea and Indonesia. If we look further at the breakdown (Table 2.3), the provision of long-term financing in Malaysia during the period under study was directed more at the agricultural sector, whereas those for Korea and Indonesia were extended more for the manufacturing sector. However, from Table 2.5, the figures show that the growth rate of long-term financing extended for the manufacturing sector in Malaysia was higher than that for the agricultural sector, whereas for all the other SEACEN countries under study, the situation reverted as the growth rates of these were higher for the agricultural sectors than those for the manufacturing sectors. This is an indication that at this stage even though the long-term financing in Malaysia was extended more to its agricultural sector than to its manufacturing sector, in the event efforts were given more at developing its manufacturing industry, as reflected in the pace of the long-term financing extended to this sector.

In terms of the ratio to total loans made available for long-term financing to the two sectors apparently Nepal ranked first, even though the figure looks somewhat high as the long-term loan data for Nepal includes all kinds of loan maturities (i.e., short-, medium-, and long-term loans). However, this phenomenon suggests that there were a lot of new investments in these sectors in Nepal from 1981 to 1990 which were financed by long-term loans. This is due, among other things, to the stage of economic development in Nepal compared to the other SEACEN member countries, indicating that a lot of new investments either in the agricultural or manufacturing sectors have been started requiring even more long-term loans in the future. For the new investments, the long-term financing was required to purchase lands, construct buildings or acquire machineries and equipments. In the case of the other SEACEN countries, the amount of long-term loans needed are relatively low since the already established industries need relatively more short-term than long-term loans for working capital. Even though the economy of Nepal is still dominated by agriculture, the data indicate that there was a tendency for more long-term financing extended to the manufacturing sector than to the agricultural sector.

By way of reviewing the ratio of the long-term financing to the value added generated in the two sectors, one can measure how efficient the long-term financing has been in contributing to the value added in each respective sector. The smaller the amount, the more efficient has been the long-term financing. From Table 2.4, it seems that Thailand was the most efficient SEACEN country in utilizing the long-term loans. During 1985-1990, the long-term financing needed by the manufacturing and agricultural sectors amounted to only 1 per cent of the total value added generated by these industries. This is followed by the Philippines and Sri Lanka at 3.6 per cent and 4.8 per cent respectively. Comparing the efficiency in long-term financing between the two sectors, apparently it is only in Thailand where the long-term financing for manufacturing sectors was more efficient than that of the agricultural sector, while in the case of the other SEACEN members, it happens that long-term financing in their agricultural sector was more efficient.

Regarding the ratio of the long-term financing of exports in both sectors, Thailand also topped the rest of the SEACEN countries during the period, with long-term loans to both sectors amounting to only 1.6 per cent of the total exports. Looking into more detail, actually the value added in Thailand generated out of long-term financing to the manufacturing sector was lower than that of the agricultural sector, namely 0.8 per cent for the manufacturing sector and 1.3 per cent for the agricultural sector. These high efficiencies probably reflect the already developed farm and industrial infrastructure and technology for these two sectors as compared to that of other countries. Of the seven member countries included in this study, Thailand and Malaysia indicated a more efficient manufacturing sector compared to the agricultural sector during the period under study. For the rest of the countries, the situation was reverse.

Long-term financing seems to influence export production in these sectors, affecting overall exports. The loan is considered efficient if relatively a small amount is needed in order to generate

Table 2.4

EMPLOYMENT IN AGRICULTURAL AND MANUFACTURING SECTORS

(In Thousand of Populations)

Country	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	growth rate (%,p.a)
Agricultural Sector														
Indonesia	...	...	31593	...	...	34142	37645	38722	40558	41284	42378	41206	42153	3.06
Korea	4654	4801	4612	4315	3914	3733	3662	3580	3484	3418	3292	3102	...	-3.62
Malaysia	1781	1811	1636	1611	1695	1717	1765	1846	1889	1833	1738	...	...	-0.24
Philippines	8894	9171	9696	10075	9705	10085	10418	9940	9920	9852	10185	...	...	1.36
Sri Lanka	537	488	471	331	448	358	364	...	...	...	2851	...	...	-6.28
Thailand	15943	13404	13294	14462	15320	15383	17816	17789	19577	...	...	...	...	2.60
Manufacturing Sector														
Indonesia	...	...	...	...	...	5796	5606	5819	5997	7335	8177	7946	8256	5.18
Korea	2955	2859	6022	3266	3348	3504	3826	4416	4667	4840	4847	4936	...	4.77
Malaysia	769	814	816	894	858	850	874	929	987	1171	1333	...	...	5.66
Philippines	1850	1780	1888	1822	1847	1926	1906	2059	2238	2298	2188	...	...	1.69
Sri Lanka	180	184	197	162	199	169	179	...	...	...	869	...	...	-0.09
Thailand	1789	1915	2206	2190	2188	2280	2069	2438	2461	...	...	...	...	4.07

Source: *Statistical Yearbook for Asia and The Pacific,* United Nations, various issues.

Table 2.5

GROWTH OF LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING 1/

(In Per Cent Per Annum)

Country	LTFA	LTFM	All Loans
Indonesia 2/ (1979-1989)	38.00	25.38	26.08
Korea 3/ (1980-1990)	23.92	21.48	21.91
Malaysia 3/ (1980-1990)	12.39	19.46	15.43
Nepal 4/ (1981-1990)	36.31	22.13	15.23
Philippines 5/ (1980-1990)	-0.94	-8.88	9.89
Sri Lanka 5/ (1980-1990)	20.12	20.01	11.94
Thailand 6/ (1985-1990)	17.22	3.26	22.21

1/ Compound growth rates
2/ Maturity of over 3 years
3/ Maturity of over 1 year
4/ All Maturities
5/ Maturity of over 5 years
6/ Long-term loans from IFCT and BAAC only, with maturity of over 5 years.

Sources: Country papers and *SEACEN Financial Statistics,* various volumes.

the same amount of exports. One way of looking at the influence of the long-term loans on total exports, although the way to measure this is somewhat rough, is by analyzing the ratio between the two. From Table 2.3, one can see that among the SEACEN countries, the influences on total exports of the long-term financing extended to the manufacturing and agricultural sector appear highest in Thailand, since the long-term financing needed by both sectors in order to generate exports amounted to 1.6 per cent, which is the smallest. This is followed by Sri Lanka, the Philippines and Indonesia. Comparing the contribution of the two sectors, long-term financing for the agricultural sector in Indonesia, Korea, Nepal, the Philippines, and Sri Lanka are more efficient in generating exports than in the case of the manufacturing sector. In the case of Malaysia long-term financing for the manufacturing sector turned out to be more efficient than that extended to the agricultural sector. For Thailand, long-term financing to both sectors appears equally efficient.

It is also useful to consider the employment generated in the agricultural and manufacturing sectors, as depicted in Table 2.4. The data show that for the period 1980 - 1992, employment in the agricultural sectors in Korea, Malaysia and Sri Lanka were on a decreasing trend annually, by 3.62 per cent, 0.24 per cent and 6.28 per cent, respectively. The downward trends in Korea and Malaysia were mainly due to labor scarcity in these countries and the new agricultural policies adopted by government to move toward using more mechanization and advanced technology. In Sri Lanka, however, the decreasing trend occurred both in the agricultural sector and the manufacturing sectors with the employment rate in the latter sector slowing down by 0.09 per cent a year. This may be due to the proportion of Sri Lankan labor working outside the country. However, with regard to employment in manufacturing in the other SEACEN member countries, the trends were generally increasing with Malaysia generating the highest (5.66 per cent p.a.), followed by Indonesia (5.18 per cent p.a.), Korea (4.77 per cent p.a.) and Thailand (4.07 per cent p.a.). These developments indicated the strenuous efforts in these countries at promoting their respective manufacturing industries.

Chart 2.1 Long-Term Financing for Agriculture and Manufacturing in Indonesia

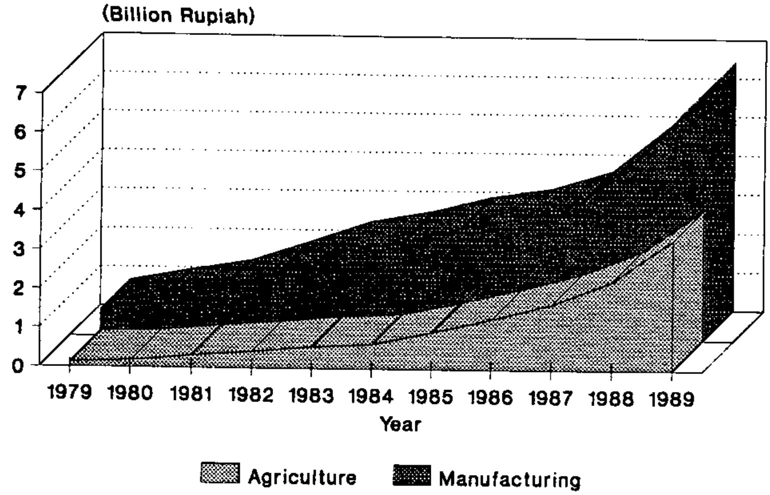


Chart 2.2 Long-Term Financing for Agriculture and Manufacturing in Korea

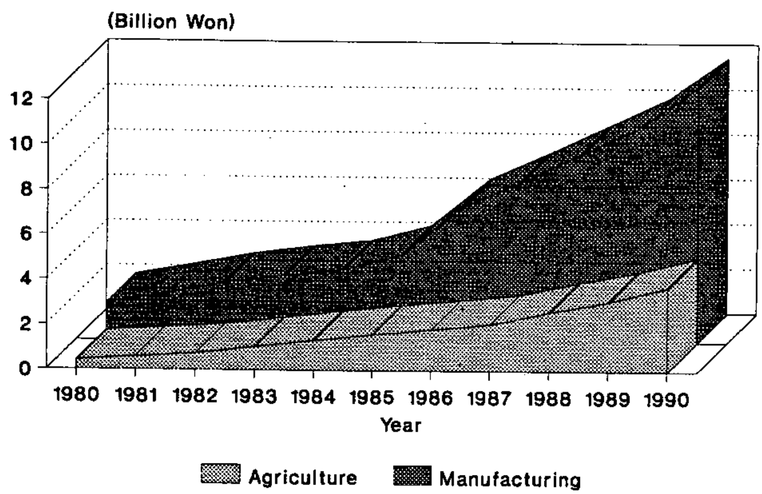


Chart 2.3 Long-Term Financing for
Agriculture and Manufacturing in Malaysia

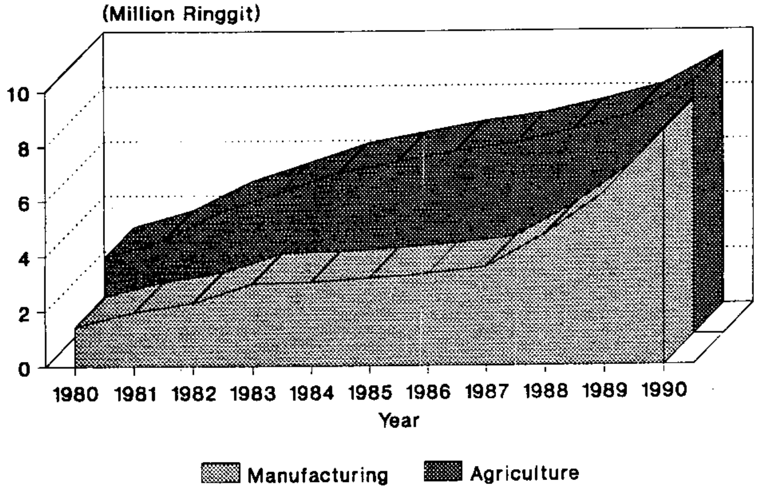
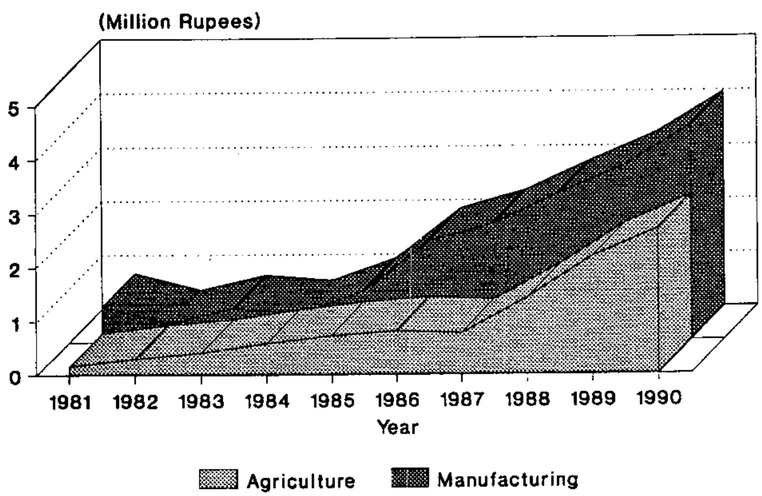


Chart 2.4 Long-Term Financing for
Agriculture and Manufacturing in Nepal 1/



1/ Data are for fiscal years ending July

Chart 2.5 Long-Term Financing for Agriculture and Manufacturing in Philippines

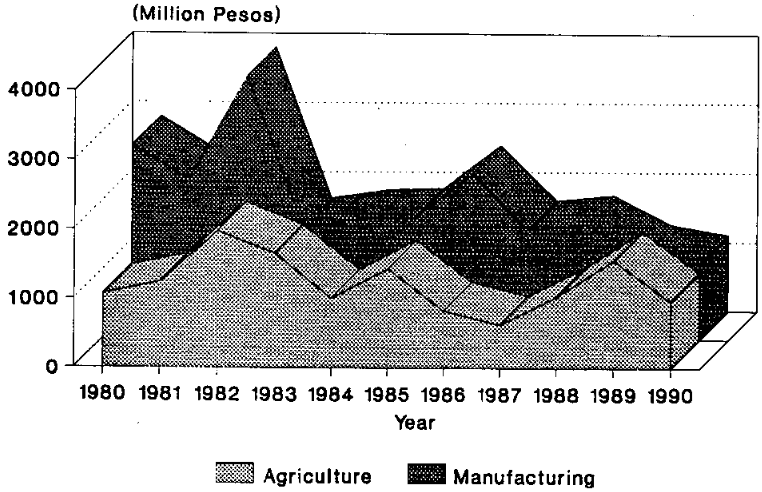


Chart 2.6 Long-Term Financing for Agriculture and Manufacturing in Sri Lanka

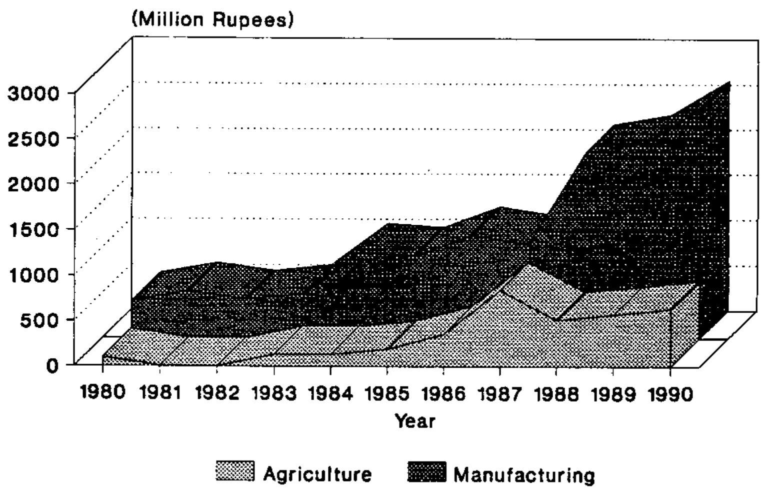


Chart 2.7 Long-Term Financing for Agriculture and Manufacturing in Thailand

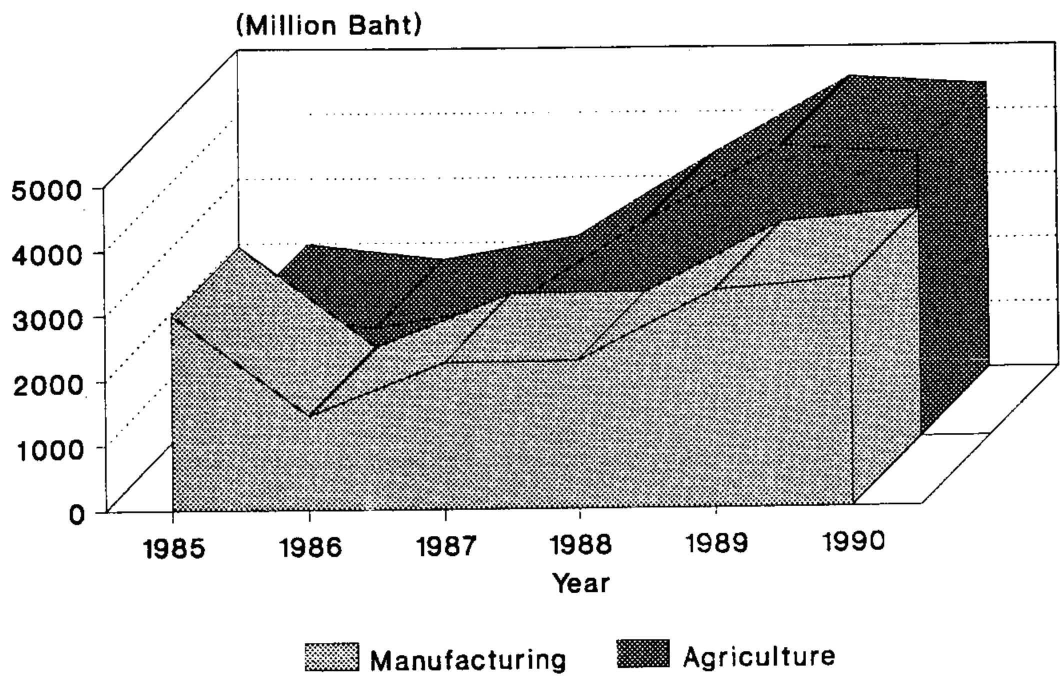
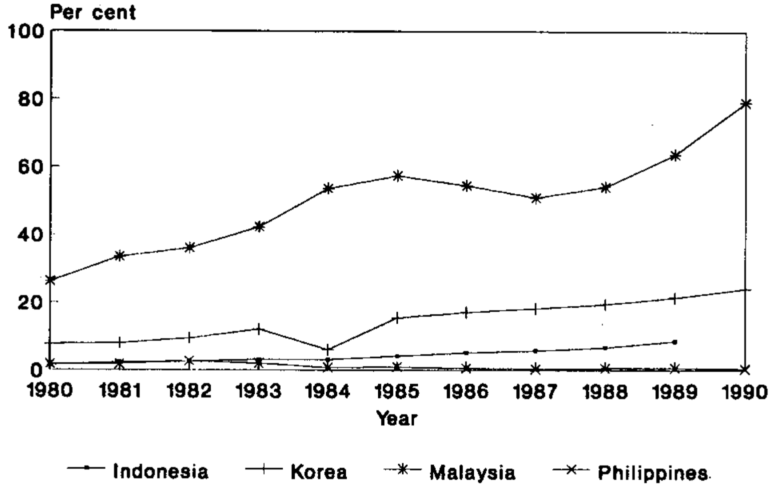


Chart 2.8 Ratio of Long-Term Financing in Agriculture to Value Added



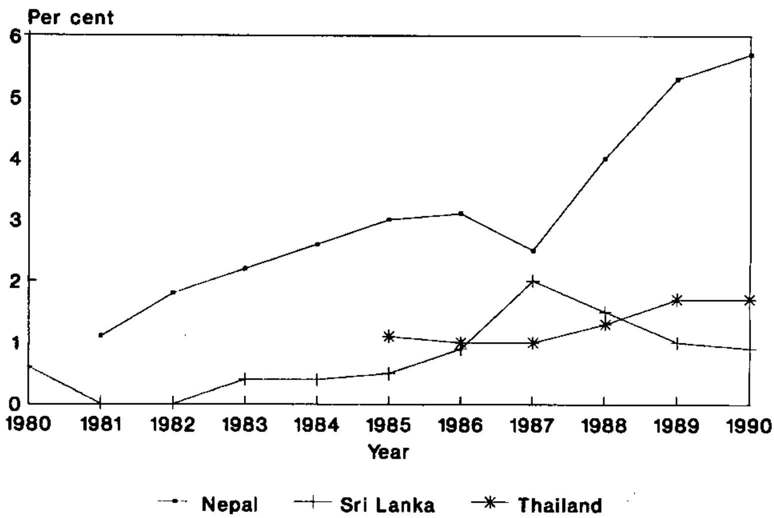
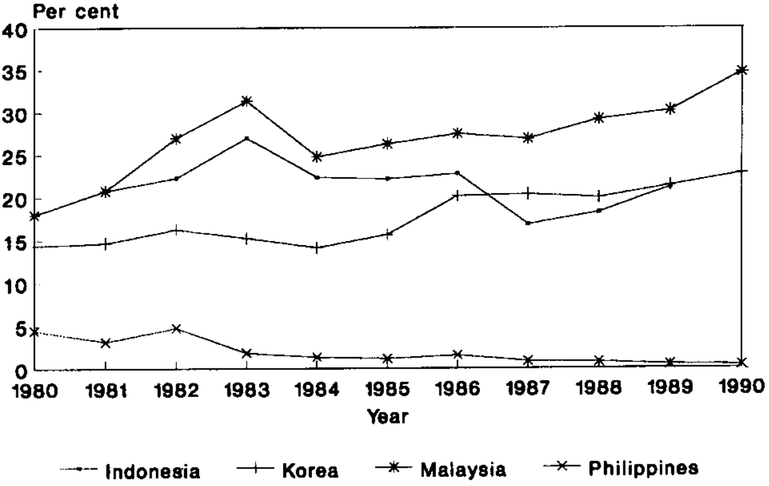
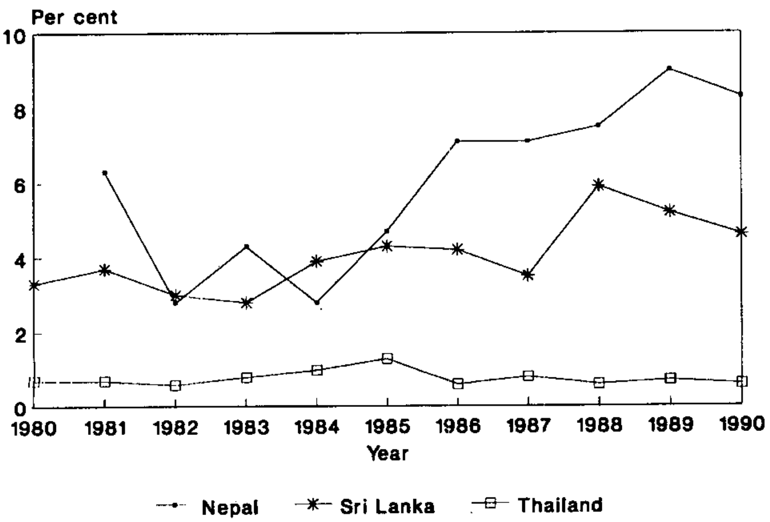


Chart 2.9 Ratio of Long-Term Financing in Manufacturing to Value Added





II. Sources of Long-Term Financing

In *Indonesia*, following a series of financial reforms starting in 1983, state commercial banks are free to manage their loan portfolios in all sectors of the economy, even though there remain tendencies at preferring to manage their specialized portfolios undertaken before the financial reforms. Three major state commercial banks specialize in providing long-term financing in agricultural and manufacturing sectors, namely, Bank Rakyat Indonesia (BRI) in agricultural sector (primarily small-holdings), Bank Ekspor Impor Indonesia (BEII) in financing production and exports of agricultural and manufacturing commodities and Bank Pembangunan Indonesia (BAPINDO) in financing manufacturing projects. Besides banking institutions, there are also two development companies -- i.e. Indonesian Development Finance Company (IDFC/UPPINDO) and Private Development Finance Company of Indonesia (PDFCI) -- dealing with long-term financing for manufacturing and agricultural sectors. In general, the principal sources of the three states banks are deposits, borrowing from Bank Indonesia and from overseas, whereas the PDFCI has relied for its sources on Borrowing from Bank Indonesia.

Similarly in *Korea*, all banking institutions can take part in long-term financing and agricultural sectors. It includes commercial banks (nationwide commercial banks, local banks and foreign bank branches), specialized banks (Industrial Bank of Korea, Citizens National Bank, the Korea Housing Bank, the credit and banking sector of the National Agricultural Cooperative Federation (NACF), the credit and banking sector of the National Federation of Fisheries Cooperatives (NFFC) and Member Cooperatives, the credit and banking sector of the National Livestock Cooperatives Federation (NLCF)) and development banking institutions (the Korea Development Bank, the Export-Import Bank of Korea and the Korea Long Term Credit Bank). In addition to banking institutions, merchant banking corporations, trust accounts of banks and life insurance companies also engage in long-term business but their market has been relatively small. By end-1990, credit and banking sectors of the NACF and NLCF are the major sources of long-term financing for agriculture, whereas for the manufacturing sector the principal long-term financing institutions are the Industrial Bank of Korea (a specialized bank), Korea Development Bank and the Korea Long-Term Credit Bank (developments institutions).

In *Malaysia*, all financial institutions and non-bank financial intermediation extend long-term financing to both the manufacturing and agricultural sectors, in addition to other sectors in the economy. Historically, the commercial banks have been concentrating their credit activities in the financing of trade and, to a smaller extent, investment goods. Overtime, this pattern had changed significantly which was attributable partly by the calls made by the central bank for the banking institutions to play a more active role towards the achievement of the nation's development objectives. In addition, the Industrial Finance Institutions (IFIs), comprising the Malaysian Industrial Development Finance (MIDF), Sabah Development Bank (SDB), Industrial Bank of Malaysia (IBM), Development Bank of Malaysia (DBM) and the Borneo Development Corporation (BDC) also provide medium and long-term financing and other financial services to the small and medium-scale entrepreneur. Meanwhile, the rural credit institutions are also involved in long-term financing to the agricultural sector. The rural credit institutions mainly consist of the rural cooperative societies, farmers associations, Agricultural Bank, and Bank Rakyat. In addition, the Federal Land Development Authority (FELDA) is also actively involved in agricultural financing and had extended a significant amount of credit to this sector. To complement FELDA's role, The Agricultural Bank of Malaysia (ABM) was established in 1969 to promote sound agricultural development through the mobilization of rural savings and the provision of credit facilities to farmers and fishermen, in addition to a variety of loan programs which catered to the needs of all levels of production, processing and marketing activities of the agricultural sectors, ranging from paddy to rubber.

In *Nepal,* the long-term financing for the agricultural sector is provided by Agricultural Development Bank (ADB) and commercial banks, while for the manufacturing sector the main provider is Nepal Industries Development Corporation (NIDC). NIDC, being the only specialized agency in providing long-term credits to manufacturing industries, contributing almost 90 percent of the total long-term financing for investment. The source of funds for ADB and NIDC are basically the same, i.e., share capital, reserve and surplus, borrowings from Nepal Rastra Bank, from the government and from abroad, and debenture issues. In addition, ADB also mobilizes public deposits as its source of funds. Meanwhile, the sources of funds of the commercial banks are share capital, reserve funds, public deposits and borrowing from Nepal Rastra Bank.

In the *Philippines*, long-term financing for agriculture by commercial banks was concentrated on agricultural crops and services. The most significant products funded were sugar cane, coconut, fruits, livestock and poultry. Meanwhile the bulk of long-term financing in manufacturing by commercial banks remained to be in the food beverage, and tobacco. Unlike other commercial banks of SEACEN member countries, commercial banks in the Philippines, aside from providing loans, also provide funding to the agricultural and manufacturing sector in the form of equity investment, but this option is limited to commercial banks with expanded banking functions or universal banks (unibanks). Apart from commercial banks, three government development banks, i.e., the Philippines National Bank (PNB), Land Bank of the Philippines (LBP) and Development Bank of the Philippines (DBP) also provide long-term fund to the manufacturing and agricultural industries, and given by 1990 data the DBP was considered as a major contributor for such lendings. Meanwhile, long-term financing to the agricultural sectors and the countryside borrowers are provided by rural banks. Another group of banks that extend significant long-term financing to the agricultural and manufacturing sectors is the Private Development Banks (PDBs). Even only at minimum amount, non-bank financial institutions also extend financing to agriculture and industry.

In *Sri Lanka*, besides the commercial banks which performed as major sources of long-term financing for agricultural sector in the last decade, there are also two development banks that provide sources of such funds, namely the Development Finance Corporation of Ceylon (DFCC) and the National Development Bank (NDB). The NDB, although its role has been declining, still performs as a major source of long-term financing for the manufacturing sector in Sri Lanka. Other institutions such as the National Saving Bank (NSB), State Mortgage and Investment Bank (SMIB), merchant banks and leasing companies also engage in providing long-term financing, although the total amount was somewhat limited. Moreover, the government since the independence in 1948 has also contributed substantially to the development on both sectors due to the lack of capital market development.

In *Thailand,* long-term borrowing for manufacturing sectors from financial institutions has been a prominent feature due to a relatively immature development of the capital market. Among the authorized financial institutions that provide credits to manufacturing sectors are The Bank of Thailand, commercial banks, finance companies, the industrial Finance Corporation of Thailand (IFCT) and the Small Industries Finance Office (SIFO). So far the commercial banks are the largest and the most important supplier of funds to the manufacturing sector, meanwhile credits from the Bank Thailand are channeled through commercial banks and IFCT in the form of refinancing facilities. The share of the commercial banks in providing the long-term loans is small, since it is naturally difficult for them to finance long-term loans due to the risk of mismatching the term of the loans. As a result, long-term industrial financing has been dominated by the IFCT, the only specialized long-term industrial financing institution in Thailand, and to a lesser extent, the SIFO. The IFCT operates along the lines of private development banks or a development company, which specializes in financing fixed assets, working capital, equity participation, collaboration in financial packaging activities with other local and foreign financial institutions, advisory services in the field of marketing, production technique and finance, and provision of guarantees and underwriting activities. In the case of agricultural credits, the Bank for Agriculture and Agricultural Cooperatives (BAAC), established in 1966, together with the commercial banks are the main source of credits to farmers and other agricultural organizations. The Bank of Thailand, apart from providing rediscounting facilities to commercial banks and BAAC, regulates and coordinates the use of funds, especially for commercial banks, and provides resources to formal credit institutions.

III. Lending Policies and Procedures

In *Indonesia,* during the period of 1983-1990, liquidity credits (rediscounting credits) were the major policy instruments of credit policy. These credits were given to selected priority sectors in agricultural and manufacturing sectors through commercial banks (especially state-owned) at below market interest rates and set by Bank Indonesia. However, these facilities were gradually abolished following the financial reform of June 1983, which was aimed at encouraging banks to mobilize funds from the public and reducing the banks' dependence on the liquidity credits from Bank Indonesia. The policies and procedures on application for long-term financing for agricultural and manufacturing sectors are set by financial institutions under the guidelines set by Bank Indonesia, taking into account the prudential requirements such as self-financing capability and project feasibility. In general, long-term financing for the agricultural and manufacturing sectors is not covered by indemnity insurance. However, on a case by case basis, the risk against default can be insured, especially for priority loans or long-term loans partly financed by foreign sources or government borrowing.

For *Korea*, lending policies for the two sectors are different according to the institutions involved. General long-term loans of commercial banks are extended on the basis of their own judgment, while in the case of policy-directed loans, the conditions and eligibilities are predetermined by the government. Specialized banks provide funds for their particular sectors, whereas development institutions supply long-term financing to support the government development policy and foster major industries or the specific sectors. There are no special guarantee institutions exclusively dealing in long-term financing for either of the two sectors. However, the Credit Guarantee Fund for Agriculture, Forestry and Fishery provides credit guarantees in connection with loans from the NACF, NFFC and NLCF. Meanwhile, the Korea Credit Guarantee Fund and the Korea Technology Credit Guarantee Fund and banking institutions provide credit guarantees in connection with loans provided by financial institutions.

In *Malaysia,* different financial institutions adopt different long-term lending policies for both agricultural and manufacturing sectors. However, direct credit control through the imposition of ceilings and lending guidelines issued by the central bank in regulating the volume and the direction of the credits. The priority sectors are set every year and the annual lending guidelines are issued every March, and the banking sector was free to determine ways and means in complying with these guidelines. In the event where any of the financial institutions failed to comply with the guidelines, a certain amount of penalties would be imposed. As for the agricultural credit institutions (ACIs), the loan condition and eligibility criteria were quite standard, such as fixed maturity period, specific repayment term, and collaterals which may be in the form of land grants or approved guarantors. The criteria used in assessing long-term loans for the manufacturing sector are similar to that of the agricultural sector, with the exception of The Industrial Bank of Malaysia which catered particularly to the shipyard and ship-repair industries.

The lending policies of the Agricultural Development Bank (ADB) and commercial banks in *Nepal* are influenced by the Government's agricultural policies and the priorities set by the Development Plan. Likewise, lending policies of the Nepal Industrial Development Corporation (NIDC) and commercial banks to the manufacturing sector are also influenced by the Government's industrial policy and the priorities set by the Development Plan.

In the *Philippines*, during the period of 1950 to 1969 lending policies and procedures of financial institutions were directly controlled through interest rate and credit ceilings. Since early 1970s, following a series of deregulations the lending policies had become more liberalized, although general prudential requirements remain including the single borrower's limit, collaterals, qualification of the borrower, purpose of loan, maturities, interest and quotas for priority sectors. The amount of loan should not exceed 70 per cent of appraised value of property offered as security, and loan maturiry should not exceed the economic life of the project to be financed. With regard to the interest rates, they are reviewed quarterly on a fixed or floating rate at the option of the borrowers and the bank. As for the collateral, the loans may be secured by first mortgage on titled or untitled immovable property and/or chattel mortgage on movable property, production stock, government bonds and securities.

Lending to the manufacturing and agricultural sectors have been prioritized in *Sri Lanka*. Tax exemptions, for example, have been offerred while lendings to the two sectors have been extended beyond credit ceilings imposed by the central bank. However, there was no specific policy with respect to interest rates associated with long-term lending. Lending procedures of long-term financing in Sri Lanka are done through careful appraisal of the technical, financial, economic, management and other relevant aspects of the project. With regard to the equity financing, the total equity investment should not exceed the institution's own equity. Some long-term lending institutions have placed limits on equity finance based on their total outstanding borrowing. For loans extended to agricultural and manufacturing sectors, the maximum exposures to a project are usually less than two thirds of the total cost of the project. Meanwhile, the exchange risk of the foreign currency loans of the NDB and DFCC is borne by the government.

To promote industrial development in *Thailand*, the IFCT provides financial support to all types of manufacturing industries with high priority given to the export-oriented projects, energy-saving projects, projects in regional areas, projects with domestic raw materials, projects which provide transfer of technology from abroad, projects with pollution control system, more labor intensive projects, supporting industries and basic industries. Interest rates applied to long-term financing extended by the IFCT from 1980 to 1990 were steady, with the average of 13.77 per cent per annum. Agricultural lending in Thailand comprises credits to individual or group of farmers, and deposits with the Bank for Agriculture and Agricultural Co-operatives (BAAC). Individual farm credit is normally advanced to big farmers who are well established but need to strengthen their capital base to improve or increase production, and the loans are advanced against securities. Group lending is made without collateral in respect of small farmers scattered around the bank branch, while deposits of commercial banks with BAAC will be made whenever their direct lending fall short of government's target. It is worth noting that the BAAC is the leading institution in providing credit to farmers in Thailand, which was established in 1966. It is a government-owned bank to provide financial assistance in order to promote the agricultural operations of individual farmers, agricultural co-operatives and farmers groups. The latter two groups re-lend the loans to their farmer members.

Chapter 3

ROLE OF CENTRAL BANKS OF SEACEN COUNTRIES IN LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS

I. Financing Facilities from Central Banks

To support development of the agricultural and manufacturing sectors, in *Indonesia* the Central Bank provides refinancing facilities on priority agricultural and manufacturing sectors at low rates, varying from 3 per cent to 14.5 per cent. It also provides guarantee of default on loans, establishes specialized credit programs and credit insurance schemes, conducts supervision and promotion of rural banking; and, obtains international financing for various sectors including agriculture and manufacturing. Following the series of financial reforms starting in June 1983, and continued in October 1988, March 1989, and January 1990, direct control by Bank Indonesia on commercial banks through interest-rate control and credit ceilings were abolished. Furthermore, the measures were also designed to increase more competition and efficiency in the banking and financial sectors. Liquidity credit was gradually phased out. However, credit to high priority sectors can still enjoy such facility but with prevailing market interest rate structure. By this policy, liquidity credit schemes were reduced from twenty-three to only four, i.e., credit for working capital to farmers (KUT), credit to cooperatives, credit for buffer stock by BULOG, and investment credit for priority sector/region. The deregulations were also designed to promote capital markets, and prioritize credits for small scale business and cooperatives, i.e., by requiring banks to extend 20 per cent of their total credits to small-scale business and cooperatives. However, foreign banks and joint venture banks which have extended 50 per cent of their total credits to the export sectors are exempted from this requirement. To foster investment activities in the eastern part of Indonesia, the maturity for investment credits for this area is adjusted according to the borrower's needs, while the maturity of credits for western part of Indonesia was set at a minimum of five years. Moreover, the share of Bank Indonesia's financing for the projects in the eastern part of Indonesia would be more than that for the western part.

Unlike in a number of other SEACEN member countries, in *Korea* there are no grants or direct financing provided by The Bank of Korea. There is also no special interest rate or interest exemption for manufacturing and agriculture. However, The Bank of Korea provides refinancing facilities to the banking institutions. The rediscount rates charged to the banks were between 3 and 7 per cent and the ratio of refinancing ranged from 50 to 100 per cent of the funds advanced by the banks. With regard to the interest rates of the banking system, The Bank of Korea influences the rates through its regulations concerning maximum interest rates on loan and deposits. The regulations apply to commercial banks and some specialized banks, though they do not directly apply to development institutions and other non-bank financial institutions.

In *Malaysia*, the role played by Bank Negara Malaysia to fulfill the long-term funding requirements of the manufacturing and agricultural sectors was indirect, since it only formulates general policies and operational guidelines in influencing the lending activities of financial institutions. An attempt to channel credit to selected priority sectors was initiated in 1975, but since then these guidelines have been subjected to annual reviews which include guidelines requiring commercial banks and finance companies to lend to priority sectors, namely the Bumiputera community, agricultural food production and small-scale enterprises. In 1990, the guidelines were further reviewed and the priority sectors only include the Bumiputera community and loans made under the Principal Guarantee Scheme (PGS) of the Credit Guarantee Corporation (CGC). To stimulate banks to provide credit to the agricultural sector in rural areas, the central bank also provides discounting facilities for agriculture bill. During the tight liquidity and high interest rates period, the government together with Bank Negara Malaysia established funds for financing selected sectors of the economy, for example, the establishment of the New Investment Fund (NIF) in 1985 which successfully met its objective and terminated in 1987 in view of the improved liquidity situation. In 1988, Bank Negara Malaysia also set up the Enterprise Rehabilitation Fund (ERF) to provide financial assistance to ailing but viable enterprises under a dedicated management with order in hand. The fund was channeled through Malaysian Industrial Development Finance (MIDF) for on-lending at the concessional interest rate of 2 per cent. In December 1989, the central bank also launched the $250 million New Entrepreneurs Fund (NEF) in line with the Government efforts to achieve the New Economic Policy through the provision of funds for new ventures by Bumiputera at reasonable cost. As at 1990, a total of $21.7 million was approved under the NEF. Lately in early 1991, the Government launched the Industrial Adjustment Fund (IAF) to facilitate the rationalization and restructuring of selected industries by providing companies with medium-term loans. The fund is administered by Bank Negara Malaysia.

For the overall development of agricultural and manufacturing sectors in *Nepal*, Nepal Rastra Bank has been actively playing roles in mobilizing resources through the promotion of various financial and finance-related institutions as well as in giving directives to banks and financial institutions. Nepal Rastra Bank directly participated in share capitals and debentures of Nepal Industrial Development Corporation (1959), Agriculture Development Bank (1967), National Insurance Corporation (Rastriya Beema Sansthan, 1967), Agriculture Project Service Centre (1974), Credit Guarantee Corporation Ltd. (1974), and Credit Information Centre (1990). Nepal Rastra Bank jointly with Nepal Industrial Development Corporation also established the Security Exchange Centre (1976) in order to promote the development of capital market in Nepal. Besides participating in share capitals, Nepal Rastra Bank also provides refinancing facilities to ADB, NIDC and commercial banks. Furthermore, the Bank also gave directives to commercial banks to invest certain portion of their resources in productive sectors such as the agricultural and manufacturing sectors; for example, 40 per cent of investment of the commercial banks should be in productive sectors.

In the *Philippines*, the Central Bank of the Philippines assumes an active role in the formulation and lending policies of banking institutions by issuing rules and regulations for the operation of the banking system, including long-term financing. The rules and regulations range from setting interest rate limits and loan values to allocating credit flows to priority sectors of the economy. The Central Bank of the Philippines is also authorized to engage in lending to banks, non-bank financial institutions and, in special cases, to key public and private corporations. The Central Bank of the Philippines engages in long-term financing through special operations including loans and advances to banks and non-bank financial intermediaries engaged in long-term lending, as well as advances for purposes of bank mergers and consolidations or the rehabilitation of industries. The Central Bank of the Philippines also administers special funds co-financed with various private and public international financial institutions, such as the Agricultural Loan Fund (ALF), the Industrial Guarantee Loan Fund (IGLF). The ALF and IGLF have been the major sources of long-term credit granted by the Central Bank of the Philippines over the years.

Similar to the other SEACEN members, the central bank in *Sri Lanka* has been actively involved in strengthening the institutional framework for long-term financing as well as providing necessary financial assistance for medium and long-term ventures. Under the Monetary Law Act (MLA), the Central Bank of Sri Lanka established Medium and Long-Term Credit Fund in July 1964. The Central Bank of Sri Lanka also provides refinancing facilities through commercial banks and other participating institutions. In a way, the central bank induces such financial intermediaries to actively engage in productive medium and long-term financing under stipulated conditions with respect to amount and lending rates. Moreover, to facilitate the long-term lending, the Central Bank of Sri Lanka in 1978 introduced a credit guarantee scheme under the Small Scale Industries (SSI) scheme in collaboration with the Industrial Development Board. The Central Bank guarantees 75 per cent of the loans granted through the two state banks and the Development Finance Corporation of Ceylon (DFCC). By this way, the difficulties faced by small and medium-size borrowers in obtaining acceptable securities against borrowings are solved. The active role of the Central Bank of Sri Lanka in promoting medium and long-term credit, especially for agricultural and manufacturing sectors, among other things, is also reflected in the coverage of its planning of credit extended by commercial banks and major long-term lending institutions, which has grown over time.

In *Thailand,* to support industrial development since 1974, the Bank of Thailand (BOT) has provided long-term loans with low interest rates for the establishment and the expansion of certain industrial enterprises through the IFCT. Eligible industries for these loans were export-oriented industries, import-substitution industries, industries with at least 20 per cent local content, and industries with domestic value added of not less than 50 per cent of the total cost. In 1978, to cope with the 5th National Economic and Social Development Plan, the list had been extended to include industries with plants located in rural areas and those with energy conservation. With regard to loans for agriculture, since 1967 the Bank of Thailand has been authorized to rediscount promissory notes arising out of agricultural transactions. However, only rediscounted loans for rural development are medium to long-term in nature, whereas those for agricultural production/husbandry and agricultural product trading are usually short-term. The rural development facility which was started in 1988/89 is essentially an investment project financing facility with 50 per cent of the promissory note drawn by the project owner to be rediscounted at a maximum rate of 3 per cent per annum and re-lent at a maximum rate of 10 per cent per annum.

II. Supervisory Problems

In *Indonesia*, the supervision of bank loans is conducted in two ways, i.e., by direct and indirect supervision. Direct supervision involves conducting regular examinations or inspections in the field, while indirect supervision examines periodic reports submitted by commercial banks to Bank Indonesia. The objectives behind both examinations are to evaluate the consistency of bank's credit policy, the system and procedures for loan, the adequacy of bank's organization and personnel, the bank's compliance, credit performance and the overall quality of earning asset in order to appraise the overall bank loan condition. This appraisal is one important part in rating the soundness of the bank. A sound bank is entitled to receive certain privileges from Bank Indonesia and the government such as expansion of the bank's operation to become a foreign exchange bank, opening of new branches, etc. For a project financed by a long-term loan containing liquidity credits, Bank Indonesia is involved in analyzing its feasibility study.

For *Korea,* the Bank of Korea does not specifically supervise the long-term financing extended by individual financial institutions to the agricultural and manufacturing sectors, but the control is done through its general supervision on the overall business of commercial banks and some specialized banks. The supervision of some other specialized banks, development institutions and non-bank financial institutions is done by the Ministry of Finance. The Bank of Korea is not involved in analyzing project proposals submitted by the borrowers, doing field inspection or recommending loans. However, it is involved indirectly in the long-term financing institution for manufacturing, i.e., the Korea Development Bank which consults with the Monetary Board.

In *Malaysia,* following the implementation of the Banking and Financial Institutions Act (BAFIA) 1989, Bank Negara Malaysia is empowered to supervise three broad groups of financial institutions, i.e., the licensed institutions, scheduled institutions and the non-scheduled institutions. The licensed institutions include major deposit-taking institutions such as commercial banks, merchant banks, finance companies, discount houses and money brokers. The scheduled institutions comprise credit and charge companies, building societies, factoring and leasing companies and also the development finance institutions. Meanwhile, the non-scheduled institutions comprise of the statutory bodies or corporations which are neither liable to be licensed under the BAFIA. The central bank is thus empowered to conduct periodic examinations and investigations into the affairs of these institutions, with the responsibility lodged in the Bank Examination Department. As in other SEACEN member countries, the supervision of banks and non-bank financial institutions is intended to ensure that banking operations are soundly conducted in the interest of the public in general and the depositors, in particular. The lending policies of the bank, including long-term lending for agricultural and manufacturing sectors, are also one area of the examination.

In *Nepal*, Nepal Rastra Bank as a central bank has full power to supervise and control banks and financial institutions. The supervision and control over long-term financing extended by commercial banks are done together with the general supervision on the overall business of the banks. In addition, Nepal Rastra Bank is directly involved in analyzing project proposals submitted by the borrowers and recommends for loans only in the case of Cottage and Small Industries (CSI) project loan under the World Bank, UNDP and HMG programs.

As in Indonesia, in the *Philippines* Bangko Sentral ng Pilipinas oversees the long-term lending operations of financial institutions directly and indirectly. The direct supervision of bank-lending activities is conducted through periodic examinations of individual banks, whereas indirect supervision is made through various limitations and requirements embodied in the rules and regulations, which in general are for pudential and sound lending practices.

For *Sri Lanka*, the Development Finance Department of the Central Bank of Sri Lanka is responsible for the evaluation of long-term loans which are made available under the Medium and Long-term Credit Fund (MLCF), by which the loans have to be approved by the Monetary board. Besides the central bank which supervises the long-term loans granted by the commercial banks, the lending institutions are also involved. Moreover, any demand for rescheduling of problem loans of other long-term lending institutions is examined in detail by the National Development Bank (NDB) or the Development Finance Corporation of Ceylon (DFCC).

As for *Thailand*, the Bank of Thailand supervises and controls its long-term credit line for manufacturing industries extended by the IFCT through pre-determined regulations and conditions. The Bank of Thailand is not directly involved in analyzing credit proposals submitted by borrowers, but is rather indirectly involved by reviewing the qualifications of the projects which have already been approved and proposed for credit by the IFCT. Therefore, the Bank of Thailand can easily supervise and control the appropriateness of the credit facility by inspecting the required documents of the eligible projects submitted by the IFCT. With regard to loan to agricultural sectors, although the Bank of Thailand has authority to direct commercial banks to extend credit to any sector, moral suasion is still being used in encouraging commercial banks to provide loans to farmers. As for BAAC, it is controlled by the Board of Directors which is chaired by the Minister of Finance.

III. Implications For the Central Bank

In all the SEACEN member countries, bank loan supervision is needed in order to reduce the risk of bank loan failure and to ensure that banking operations are soundly and efficiently conducted. With the exception of Indonesia where the central bank has special departments which conduct indirect and direct supervision on the bank loans, the supervision of the bank loans by most SEACEN central banks is done under its general supervision on the overall business of the operating banks. In general, the involvement of the central banks in the long-term loan business is confined to providing/channeling funds through financial or non-financial institutions.

In the case of *Indonesia,* the direct involvement of the central bank in providing long-term loan is due to the limited sources for long-term funds for investment purposes. Bank Indonesia, therefore, provides liquidity credits for investments which are normally long-term in nature. The liquidity credits are channeled through commercial banks and development type of non-bank financial institutions, at prevailing market interest rates. To ensure that the credits are utilized properly, Bank Indonesia is thus directly involved in analyzing feasibility study of the proposed projects and recommending the loans, based on various aspects including legal, management, technical, financial, prospect and value added of the project in question. It is felt, however, that the involvement of Bank Indonesia creates bureaucratic procedures that cause delays or longer processing time.

In *Korea,* The Bank of Korea participates indirectly in long-term financing business through its supply of funds to financial institutions which provide special long-term financing, thus there is no concern on delays of processing the loans. To minimize the risk of loan defaults, The Bank of Korea strengthened credit screening by individual banks providing the funds and encouraged the more active use of guarantee institutions. The only concern for The Bank of Korea is the divisional authority for supervision. The long-term financing extended by the special banks, development institutions and other financial institutions comes under the control of the Minister of Finance, while those from commercial banks and some specialized banks come under the control of The Bank of Korea. Thus, there is no comprehensive system arranged for the overall regulation of long-term financing.

In *Malaysia,* Bank Negara Malaysia does not participate directly in long-term financing. Its involvement is confined to providing/channeling funds for special scheme set by the Bank or the Government for on-lending through the banking institutions and specialized institutions (such as the IFIs and ACIs) to the target sectors. In order to ensure that the funds are disbursed to the proper participating institutions, channeled to the eligible sectors and borrowers and do not deviate from the main objectives of the funds, a regular and specific reporting system to the Treasury and Central Bank was made compulsory. Through these periodic reports, the necessary monitoring and checks can be carried out. The BAFIA 1989 which provides for integrated supervision of the Malaysian financial system and aimed at modernizing and streamlining the laws related to banking also govern the operation of the long-term financing provided by the financial institutions.

For *Nepal,* the central bank gives full liberty to banks and financial institutions to invest their resources in addition to the general guidance to invest a certain percentage of their funds in productive sectors as determined in the development plan. Nepal Rastra Bank is not involved in project analysis and sanctioning the loans, so there is no question of delay on the processing of the loans. Nepal Rastra Bank is only responsible for determining whether the institutions have properly utilized their resources and have made a timely repayment of the loans. Since Nepal Rastra Bank is represented in most of the financial institutions' boards to formulate and provide guidelines, policy, program, and investment target and loan recovery, Nepal Rastra Bank is therefore involved directly and indirectly in the financial institutions' activities for effective utilization of funds.

In the *Philippines,* the administration of the Industrial Guarantee Loan Fund (IGLF) and the Agricultural Loan Fund (ALF) has been transferred lately to the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP), therefore the Central Bank of the Philippines can concentrate on its monetary stabilization function. The new law (Republic Act No. 7653) establishing Bangko Sentral ng Pilipinas in July 1993 contains a provision which prohibits the Central Bank of the Philippines from exercising development financing functions, except in cases where it will merely serve as a conduit for funds coming from international financial institutions. One of the main thrusts of the new law is to avoid a repetition of substantial operating losses under previously subsidized rediscounting and special financing facilities of the old central bank.

For *Sri Lanka,* the central bank is not involved directly in long-term lending for agricultural and manufacturing sectors. Instead, it is involved indirectly through the provision of refinancing credit facilities extended under the Medium and Long-Term Credit Fund (MLCF). Hence the risk of defaults is not borne by the bank, but rather rests with participating lending institutions, including commercial banks, the National Development Bank (NDB) and the Development Finance Corporation of Ceylon (DFCC). However, the refinancing credit extended by the central bank under the MLCF has emerged as a major item in total refinancing as well as in the monetary base, thereby creating problems on controlling the money supply.

As in other SEACEN countries, in *Thailand* the Bank of Thailand is not directly involved in the provision of the long-term financing for agricultural and manufacturing sectors. The Bank of Thailand only provides refinancing facilities to commercial banks and financial institutions which are in charge of providing the loans to these sectors.

Chapter 4

ISSUES AND SUGGESTIONS ON LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN SEACEN COUNTRIES

I. Factors Limiting Access to Institutional Credit

In *Indonesia,* before the financial reform of January 1990, there was discrimination in the distribution of liquidity credits from the central bank. Most of the long-term loans extended by state commercial banks and non-bank financial institutions via selective credit policy instruments came from the liquidity credits originating from the central bank, whereas private commercial banks obtained very little liquidity credit for funding long-term loans. The private banks therefore had to rely on their own funds mobilized from savings and time deposits. This situation had of course created unfair competition between the state and private commercial banks, and also limited the access of borrowers in obtaining long-term loans from private commercial banks. To the central bank, however, the liquidity credits were very costly to administer. Similarly, they also caused the operation of the state commercial bank to become less efficient. The phasing out of the liquidity credits following the financial reform somehow improved the business of the banking system which became more market-oriented, but new problems occurred since there was an excess demand of long-term loans in the market which could not be met by domestic sources. The investors then had to finance their project with short-term loans which were costly, or out of off-shore funds. However, recently these problems have been partly resolved with the emerging capital market in Indonesia.

For *Korea,* policy-directed long-term financing somehow created the financial sector. Since the eligibility and the amount of funding are determined by the government, these restricted the exercise of the credit evaluation capabilities of the financial institutions and led to neglect of the appropriate management of the loans. Moreover, the commercial banks fund the policy-directed long-term financing out of their short-term liabilities which led them to a difficult situation in matching their sources of funds. As in Indonesia, there was excess demand for long-term financing in Korea, and a part of it was eventually financed through short-term financing and private liabilities.

As for *Malaysia*, Bank Negara Malaysia through moral suasion urges financial institutions to adapt their credit policies to be more development-oriented. However, there remain impediments which limit access to institutional credit. In agricultural credits, for example, many of the credits had been channeled to big farmers and estates growing cash crops rather than to the smaller ones. From the banking side, the unwillingness of banks to extend credits to small borrowers is often because of the viability of their projects; while looking from the small farmer's side, their access is somewhat limited by the complexity and formality of procedures and lack of information regarding the available financing scheme.

The classical problems are also found in *Nepal*, as limited access to institutional credits is mainly due to the lengthy lending procedures of the financial institutions so that the entrepreneurs with little idea on project proposals are hesitant to approach the financial institutions for loans. Sometimes, the bank staffs are not cooperative with the borrowers and there is too much rigidity in the formalities for lending. Many of the borrowers are not aware of the government programs and bank schemes due to poor transportation and communications facilities.

The market-oriented environment of the banking system since 1970s in the *Philippines*, has facilitated more competition, and thus encouraged efficiency and additional sources of financing within the financial system. While in general these reforms especially those in the 1980s have contributed to greater access to institutional credit, some regulations and policies continue to limit the flow of credits, including long-term credits, to the borrowers. These include the quotas on credits, the gross receipt tax on bank income, high reserve requirements and special lending programs. Another source of the lack of funding for long-term projects is the structure of bank's main source of funding, which is mostly short-term in nature tending towards the banks requiring this maturity structure in their loan portfolios.

Due to the stage of development in *Sri Lanka*, there were several constraints which limit the access of institutional credit for the manufacturing and agricultural sectors. The tendency of small and - medium type ventures which seldom rely on capital markets for funds and more on development and commercial banks exerted pressure on limited long-term funds from these banks. Meanwhile, the extensive use of long-term finance by the government for its budgetary purposes limits the availability of these funds for private investment in both sectors.

The lender's margin and maximum lending rates for loanable funds provided by the Central Bank under the MLCF and foreign funds obtained for long-term lending, was also another problem. Lastly, the problem was also prevalent among the commercial banks as their resource base was short-term in nature.

For *Thailand*, it is felt that long-term credits to manufacturing sector were not optimally distributed. The credits were generally provided to firms which generally have good relationships with the bankers or were classified as credit worthy customers, located in urban area and having sufficient collaterals. Meanwhile, small and medium firms in provincial areas which usually have very low capital, insufficient collateral and low creditworthiness, lacked the access. Moreover, the cost of lending to the small firms is usually higher than that of the large firms, which discourages the small firms from borrowing. Viewed from supplier side, apparently the IFCT is the only institution which provides the long-term loans, whereas other institutions such as SIFO can provide only medium-term loans, with maturities of less than 5 years. This was due to the fact that in the period under study, given the structure of interest rates in Thailand, mobilization of long-term funds through time deposits was very difficult. Another factor which contributed to limiting the access to institutional credits was the interest rate ceiling set by the Bank of Thailand, which aimed at maintaining the stability of domestic interest rates. However, since quite often the ceiling was lower than the prevailing market rates, the commercial banks and other financial institutions accordingly tended to extend their loans only to low-risk customers with sufficient collaterals. With regard to agricultural lending, the collateral is the main factor which limits the access to institutional credits. The other factors, among other things, are lending practices and attitudes.

II. Repayment Problems

Loan delinquency and loan default are common problems in every banking system in the SEACEN countries, the difference among them is the degree of severity. Many of the problems happened in the agricultural sector, since this sector is very vulnerable to the unexpected weather conditions. *Indonesia*, as a country where the agricultural sector still plays an important role, loan delinquency and loan default in agriculture seem to be a common phenomenon. Besides inappropriate management of the loan as one of the reasons for the defaults, the other reasons were adverse environment conditions which are beyond the control of the farmers, and the bad attitude of the farmers/companies toward repayment of the loans. The preventive measures so as to avoid the repayment problems of the investment credits, which are financed by liquidity credits, include a repayment schedule which reflects the firm's projected cash flow that is submitted upon application for credit.

The same happened also in *Malaysia,* as credit institutions which provide agricultural credits had found themselves saddled with increasing debts. Poor repayment attitudes of farmers in Malaysia was most prevalent among borrowers from small production units in areas where the component of government subsidies was high. The borrowers often had the wrong impression that the involvement of the government in the financial scheme meant subsidies for them for which they were reluctant to repay. It was also very unfortunate that farmers sometime did not utilize the credits to increase their production and income, but rather utilized the credit for consumption purposes. From the credit supplier, in addition to the limited expertise in evaluating the risk in this sector, improper credit allocation procedures and failure to properly follow up on the disbursed loans had generally resulted in bad debts.

In the case of *Nepal,* the capability of the borrowers to repay the loan depended much on the weather conditions, as agriculture in this country mostly depends on monsoon rain. Limited opportunities to market manufacturing products due to lack of transportation facilities and tough competition from Indian products are among the factors that broke many industrial ventures in Nepal and thus created problem loans. Beside these factors, banks' irresponsible attitude and the inconsistent policies of government with regard to the agricultural and manufacturing sectors are other factors that caused loan defaults.

In the *Philippines,* there were no significant cases of loan defaults and delinquency in long-term loans granted by banks because of strict collateral requirements imposed on the borrowers. In some isolated cases, collateral deficiencies arose from some self-dealing activities among bank management staff.

For *Sri Lanka,* the repayment problems occurred mostly for commercial banks, specially the two state banks which are largely responsible for long-term lending, but not for the Development Finance Corporation of Ceylon (DFCC) and the National Development Bank

(NDB). A 1989 study by the World Bank found that the two state banks comprising 70 per cent of the banking system had estimated non-performing assets representing at least 35 per cent of their total portfolio.

In *Thailand,* repayment policies and procedures of long-term financing for manufacturing sector are independently determined by the individual financial institutions. Generally, repayment was done through monthly installments with some grace period. Repayment problems such as loan defaults or loan delinquency on long-term financing for manufacturing sector were rarely found because all approved projects had been evaluated carefully and any problems occurring after loan disbursement would be solved by the team of IFCT which was dispatched to the field immediately. Likewise, there were few cases of repayment problems on the long-term loan for agriculture. For those having problems, they were normally permitted to reschedule the repayment. The few cases of loan default were generally attributable to unexpected household expenses and excessive debts with private creditors.

III. Future Needs of Long-Term Financing

In the case of *Indonesia,* the Sixth Five-Year Development Plan (REPELITA VI) starting 1994/95 provides priorities to develop the eastern region, where development is somewhat lagging behind that of the western region due to the limited government budget. To promote economic activities and to support an equitable development in this region, in addition to public sector investment, a lot of private investment either in the form of foreign direct investment or private domestic investment will be needed requiring substantial amounts of long-term funding. Apart from the government's intention to develop the eastern region in general, efforts to boost the efficiency and the international competitiveness of manufacturing products in order to promote non-oil exports will also certainly need long-term funds.

In *Korea,* during 1980-1990, the growth in long-term financing for agricultural and manufacturing sectors outpaced that of total financing, and this trend is expected to continue further. The rapid mechanization and the enlargement of farms in order to overcome the labor shortage are some of the reason. The external pressure for opening the domestic agricultural market and the efforts of the government to commercialize advanced technology to improve international competitiveness will also certainly need more long-term financing.

For *Malaysia,* since the country has set its sights on achieving the status of a fully developed nation by the year 2020, to achieve this objective financial support must be made available in order to catch up with an acceleration of industrialization. In the manufacturing sector, a lot of efforts have to be done to open new investment, replace obsolete machinery and equipment, and also to support research and development so as to ensure that the product would be in line with the rapid changes in world demand. In the case of the agricultural loans, future lending activities are also expected to rise as the need for capital requirements by farmers is increasing with the higher demand for agricultural produce and given that the subsidy programme is being downsized.

Like the other SEACEN countries, *Nepal's* needs for long-term financing for agricultural and manufacturing sectors are expected to increase continuously. In the agricultural sectors, it is expected that the loans are needed to finance tenants at purchasing lands from landlords, to improve land productivity through various means including modern agricultural methods, whereas more loans are also required by the gradual development of manufacturing activities in the country.

In line with the industrialization process in *Thailand,* the need for long-term financing in the manufacturing sector will grow continuously. The Ordinary Least Square (OLS) estimation provided by the country researcher in this study found that the elasticity of demand for long-term financing with respect to real GDP during 1980-1990 is 1.76, indicating that with every additional 1 per cent growth in real GDP, the demand for long-term financing will grow by 1.76 per cent. Since the economy of Thailand is expected to continue to grow strongly in the near future, the need for long-term financing in the manufacturing sector will also be large. In the case of the need for long-term financing in the agricultural sector, it will certainly grow in parallel with efforts of the government to improve funding allocations and procedures for this sector. However, it is envisaged that the growth in long-term funds needed for the manufacturing sector will be faster than that for the agricultural sector, given the transition of the economy towards a more industrialized country.

IV. Recommendations for Further Improvements

The recommendation for further improvements of long-term financing for the agricultural and manufacturing sectors are based mainly on the factors limiting access to such credits, repayment problems, and future demand.

Given the factors limiting access to the long-term financing and in efforts to increase the efficiency of such lending in *Indonesia,* it is necessary that a wider range of instruments suitable to the needs for long-term financing in the agricultural and manufacturing sectors be created. Particularly, to meet the needs for long-term funding for development in the eastern part of Indonesia, where currently the supply from domestic sources is rather short, it is necessary that direct foreign investments in this region be promoted by, among others, simplifying the investment procedures and making the business climate more attractive for them. Moreover, the government could also play a more active role by having various institutions invest a certain percentage of their pension funds in the bond markets, as to facilitate the business of capital market at efforts to mobilize long-term funds from the public.

In *Korea,* to improve the allocative efficiency of long-term lending, policy reforms in this area are deemed necessary. It is felt that the monetary authority was involved too much in policy-directed loan-financing, i.e., in setting the loan target and its allocation. It is desirable that the authorities set only the guidelines while the decision on loans and their allocation be given to individual institutions. In this way, it is expected that the institutions will be able to improve their technique on credit evaluation. It is also recommended that the allocation of long-term loans and the follow-up management of the disbursed loans be made more efficient. For the expansion of the long-term loan business to cope with the increase in future needs for loans, the commercial banks should be permitted to issue debentures and to lengthen the maximum period for the loans.

For *Malaysia,* it is suggested that the financial institutions be more innovative in creating new types of financial instruments which can be used effectively to finance and support industrial development. This is because long-term financing is expected to be extended beyond large, capital intensive and sophisticated technology industries to small and medium-scale industries as well to enable them to participate more effectively in the economy. Among the possibilities for new types of instruments that the authority could consider are venture capital and debenture financing. Other opportunities include concerted efforts to develop corporate bonds or private debt securities market. This would enable potential investors to raise funds directly from the market. With regard to long-term loans to the agricultural sector, the cost of loans should be reduced and the loans must be made more accessible to small farmers. To reach small farmers in rural areas, the appointment of agents by commercial banks and non-bank financial institutions in rural areas to channel the credit could be exercised, as has been done by the Agricultural Bank of Malaysia (ABM). This method will broaden the coverage of banks' lending operation in the rural areas and provide better accessibility to farmers. Another possibility for improving the efficiency of lending to farmers is by extending the credits to a group of borrowers, such as a village or a group of farmers with a common project, wherein all in the group are jointly liable for the loan. These groups have the advantage of providing mutual support to their members, creating a sense of confidence, solidarity and self-reliance, which small farmers so often lack. This is a large effort since in the past agricultural loans have been turning into bad debts. Hence, the establishment of an agricultural insurance scheme would be very timely, as the scheme can cushion against non-repayment risk as well as providing assurance for the credit.

For *Nepal,* the problems faced by the borrowers or lenders in obtaining or providing the loans are mainly due to the complicated procedures, shortage of skilled staff in appraising the project proposal and the inadequate responsibility by the bank staff. To remedy these problems, it is suggested that the banking procedures in obtaining such loans be simplified and easy to understand. Besides, an improvement in the quality and in the attitude of the human resources is also necessary.

In the *Philippines,* it is considered necessary to match the maturity profiles of the banks' portfolio with those of their borrowed funds. This can be done, among others, by tapping potential fund sources such as pension funds and insurance companies, promoting capital markets and enhancing the mobilization of funds. Further, financial reforms to liberalize rules on bank branching and the entry of foreign banks, reduction in reserve requirements and phasing-out of the gross receipt tax on bank revenues will perhaps be of great advantage. On the demand side, more efforts should be taken to encourage more entrepreneurs to put up more viable projects.

For *Sri Lanka,* it is recommended that the long-term savings institutions such as Employees' Provident Fund, Employees' Trust Fund and the National Saving Bank be allowed freedom to augment the resource base of the DFCC and NDB and invest directly in private sector debentures. This is because the pre-exemption of long-term funds by the government has caused problems in the mobilization of long-term funds for long-term lending. By allowing the long-term savings institutions to invest in private company shares, the long-term finance institutions would be encouraged to meet the demand. Meanwhile, in view of meeting the increasing demand in the future, it is suggested that financial institutions consider the introduction of a variable interest-rate mechanism on their lending of long-term funds.

For *Thailand,* for the improvement of long-term financing for the manufacturing sector, it is proposed that a liberalization of interest rates be continued so as to become more market-determined. Related financial policies should be improved so as to allow more mobilization of long-term funds from public; the Small Industrial Finance Corporation of Thailand (SIFCT) be established to streamline long-term credits for small industries in provincial areas; and capital markets be developed. With regard to long-term lending to the agricultural sector, efforts are needed to improve and consolidate the agricultural credit system before the increasing demand for farm credit occurs.

Chapter 5

MAJOR FINDINGS AND CONCLUDING REMARKS

It is observed in the study that long-term financing for agricultural and manufacturing sectors are urgently needed by all SEACEN member countries, as the stages of their respective economic developments are either still early or well into the transition. The economic development policy of the country also determine the needs for these financing. Some countries are now putting more efforts on their manufacturing industries as their development policies are moving toward industrialization, whereas some other countries are still concentrating on developing their agricultural sector. Comparing the needs between the long-term financing for the agricultural sector and manufacturing sectors among the SEACEN member countries under study, it is found that, except for Malaysia, long-term financing requirements for manufacturing sector in Indonesia, Korea, Philippines, Nepal and Sri Lanka are greater than those for the agricultural sector, while for Thailand long-term financing is equally needed for both sectors. This is an indication that at this stage, the majority of the SEACEN member countries are now giving more efforts to develop their manufacturing industries. This finding is supported by the data on the growth rate of employment in the two sectors, where for the majority of the SEACEN member countries the growth rate of employment in the manufacturing sector is much higher than that of the agricultural sector. The observations are even more supported by the fact that, in 1993, the contribution of the manufacturing sector to the formation of their GDP in almost all SEACEN member countries is higher than that of the agricultural sector.

For *Indonesia,* the average growth rate of long-term financing for agricultural and manufacturing sectors is faster than that for total financing in both sectors. To implement the Sixth Five-Year Development Plan (REPELITA VI) starting 1994/95, which focuses on the development of the eastern part of Indonesia much more long-term financing for these sectors is needed. These fast growing needs in the near future for long-term financing in both sectors must be supported by the banking sector or non-bank financial institutions. Otherwise, the target for economic development cannot be achieved. Following the financial reform of January 1990, however, the number of sectors eligible for liquidity credit was reduced. Given such a situation, the demand for long-term financing in both sectors must be met by obtaining funds from other sources, or through the creation of new instruments which certainly requires the banking system to be more innovative. With regard to supervising and controlling the provision of long-term financing, Bank Indonesia is also involved in analyzing the feasibility study of the project containing liquidity credit. This is understandable, as at this moment its involvement is still considered necessary to prevent loan delinquency and loan default, even though the procedure is somewhat too bureaucratic and might cause delays in the processing of the credits.

In *Korea*, the ratio of long-term financing for the two sectors to GDP was increasing steadily during 1980-1990, and the trend is expected to continue in the near future. Observing the share of these sectors to GDP, it is clear that the manufacturing sector has a bigger role than the agricultural sector, as reflected also in the growth rate of employment in these two sector, in which employment in the agricultural sector is declining by 3.62 per cent per annum, whereas for the manufacturing sector it is increasing by 4.77 per cent per annum. Unlike that of Bank Indonesia, The Bank of Korea provides no grants or direct financing specifically for manufacturing and agriculture. Rather, it indirectly supports through refinancing facilities provided for commercial banks and specialized banks. The Bank of Korea also does not provide preferential rates or interest exemptions, but the bank influences the interest rates through its regulation concerning maximum interest rates on loan and deposits. With regard to the supervision of long-term financing, though The Bank of Korea does not do it specifically, it exercises control over long-term financing nonetheless through its general supervision of the overall business of the institutions concerned. At this moment, policy-directed long-term financing is one area of concern in Korea, since this policy restricts the credit evaluation capabilities of individual institutions. Besides, commercial banks are also involved in implementing this policy even as they lack the instruments for mobilizing long-term funds. It is envisaged that these factors somewhat impede the enlargement of long-term financing business of the banking institutions.

As in Indonesia, in *Malaysia* the long-term loans extended to the agricultural and manufacturing sector grew more rapidly than total loans extended to these sectors. Another finding from the study shows that although the amount of long-term loans extended to the agricultural sector was greater than that for the manufacturing sector, the ratio of long-term financing extended to this sector over its aggregate financing had been declining. This was attributable to the tendency of the credit institutions to provide loan to more potentially growing sector, i.e., manufacturing and property sectors. Therefore, the share of the long-term financing for the manufacturing sector over total long-term financing of all sectors had been rising, indicating that the industrialization process was underway. This finding was also supported by the data on employment, which showed that employment in the agricultural sector was declining by 0.24 per cent per annum, while for the manufacturing sector it was increasing by 5.66 per cent per annum. Looking ahead, the prospects of the Malaysian economy remain strong. The manufacturing sector is expected to play a dominant role as the engine for economic growth, therefore more resources -including long-term financing- are needed to finance the expansion and the modernization of productive capacity which can be translated into bigger lending and investment opportunity for the banking industry. It looks likely that this trend will continue on in line with the objective of the government to become an industrialized country in the year 2020.

For *Nepal*, it is found that investments funded by financial institutions are chiefly concentrated in the urban centers and selected rural areas, due mainly to the geophysical location of the country and the lack of communications and transportation within the country. Being a country where agriculture is very dominant, the role of agricultural financing is very important for this country. However, the data showed that long-term financing extended to the manufacturing sector is larger than those extended to the agricultural sector. This is because investments on agricultural sector had been started long time ago so that this industry does not really need much more long-term funds; instead, it needs more short-term funds for working capital, while the manufacturing industry has just recently started so it needs more long-term financing to acquire land, building and machineries.

The ratio of total long-term financing extended to the agricultural and manufacturing sectors over GDP in the *Philippines* was considered low compared to that of other SEACEN countries, where averaged in 1980-1990 to only 0.8 per cent, of which only 0.3 per cent of GDP was extended to the agricultural sector and 0.5 of GDP per cent to the manufacturing sector. However, even though the ratio of long-term loans extended to the agricultural sector was only small, from 1980 to 1990 it grew at an annual rate of 7.3 per cent, while that for the manufacturing sector declined by 3.1 per cent annually. In the Philippines, commercial banks and specialized government banks have the biggest role in providing long-term financing to the agricultural and manufacturing sectors. However, as at end-1990, the total long-term financing extended by the commercial banks to both sectors was bigger than that extended by specialized government banks. Moreover, though in a very limited amount, savings banks, rural banks and private development banks apparently also supply long-term financing to these two industries. It is found in this study, that until now there are government policies and regulations that limit access to or the supply of credit, including long-term credit to the manufacturing and agricultural sectors, even though the financial system has been liberalized since the 1970s. These policies and regulations included the Agri-Agra Law and other similar quotas on lending to certain priority sectors and geographical areas, the gross receipt tax on bank income, high reserve requirements, and the special lending programs of the government. Given all these constraints, it is necessary for the central bank to further improve its prudential rules and regulations to meet the increasing demand for long-term financing in both sectors to support the growth of the economy.

In *Sri Lanka*, the Development Finance Corporation of Ceylon (DFCC), the National Development Bank (NDB) and the commercial banks were the major institutions providing long-term financing for the agricultural and manufacturing sectors. The main sources of DFCC and NDB were borrowings and repayments from their borrowers for loanable funds, while for the commercial banks they were deposits accepted from the public. By way of looking at the ratio of the total financing for both sectors over GDP, the importance of these industries to the economy becomes very evident as reflected in the significant increase of the ratios, which fluctuated at around 40 to 45 percent during 1980-1990. The limited role played by capital markets exerted pressure on institutional long-term finance, further aggravated by the use of medium and long-term institutional finance by the government for its budgetary purposes. Given the expected increase in the demand for long-term financing in the near future, the DFCC, NDB and commercial banks have to be more innovative in finding long-term sources while the government could release some of the long-term funds currently used for its budgetary purposes.

There are two important institutions which provide long-term financing for manufacturing sector in *Thailand*, namely The Industrial Finance Corporation of Thailand (IFCT) and the Small Industries Finance Office (SIFO). Between the two, IFCT is the most important institutional source in providing the long-term financing for this sector. The commercial banks also play a role in financing the manufacturing sector. However, their credits are mostly short-term in nature with maturity of less than 3 years. The Bank of Thailand, as the central bank, provides refinancing facilities for the IFCT, and also for the commercial banks. In addition to its own capital, IFCT's principal sources of funds are concessional loans from aid agencies and aid-related institutions of foreign government, which all are guaranteed by the Thai government. Also, the IFCT mobilizes funds through the issuance of debentures and financial papers in the domestic markets. Repayment problems such as loan defaults or loan delinquency are rarely found, since all projects financed by the IFCT have been properly examined and passed the project appraisal procedures including the market, technical, managerial, financial and including all aspects related to economic and environmental dimensions. One area of concern pertaining the provision of long-term financing is that the small- and medium-sized firms in provincial areas, which account for more than 90 per cent of the number of industrial plants in Thailand, still lack long-term institutional credits, due to several factors which originate from both the demand and supply sides. Among these factors are the limited availability of long-term financial institutions, limited financial instruments to mobilize long-term funds, the existence of interest rate ceiling and the unavailability of branch network in provincial areas. In line with efforts of the government to move toward an industrialized country, the need for long-term financing in the manufacturing sector in the future will become more pressing, and the immediate solution to the concerns mentioned here would certainly be the best policy. With regard to the long-term financing to the agricultural sector, it is observed that there were also obstacles and constraints which limit the access of farmers to institutional credits, such as loaning procedures, land tenure, identification and formulation of the project, mandatory lending policy, rediscount facility as well as the interest rate and financial policies.

Bibliography

Committee to Review the Functioning of Financial Institutions, *Progress Report on the Financing of Industry and Trade,* Her Majesty's Stationary Office, London, 1978.

James, Kenneth, "Fiscal and Financial Factors Affecting Small and Medium Business Improvement in the ASEAN Region," *Asean Economic Bulletin,* March 1986, pp.153 - 167.

Kehnert, Walter Schaefer and John D.Von Pischke, *Agricultural Credit Policy in Developing Countries,* World Bank Reprint Series, No. 280,

Mangkusuwondo, Suhadi, *Industrialization Efforts in Indonesia: The Role of Agricultural and Foreign Trade in the Development of an Industrial Sector,* Ph.D. Dissertation, University of California, Berkeley, 1967.

Rao, N.K. Muralidhara, *Agricultural Finance in South East Asia, Some Lessons for India,* Vijaya Tejashvi Publishers, Hyderabad, 1978.

The SEACEN Research and Training Centre, *Agricultural Credit in South-East Asian Central Banks (SEACEN) Countries,* Petaling Jaya, Malaysia, 1978.

The SEACEN Research and Training Centre, *The Recent Trends in Agro-Industrial Credit Facilities: Problems and Issues in the SEACEN Countries,* Seminar Report, Kuala Lumpur, Malaysia, 1989.

Indonesia
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Billion Rupiah)

Year	Total Long-term Financing for Agriculture and Manufacturing	GDP at Current Price	Total Exports (fob)	Value Added in the two Sectors	Total Loans
1979	803	32005	9713.5	12306.3	6268
1980	1123	45446	15016.4	16578.2	7880
1981	1522	58127	15898.2	20764.9	10159
1982	2145	62476	14768.2	22544.5	13022
1983	2777	77623	19227.2	27661.1	15299
1984	3115	89885	22455.8	33532.6	18813
1985	3812	96997	20642.4	38016.2	22157
1986	4390	102683	18463.8	42055.6	26402
1987	5257	124817	28284.1	50266.4	32852
1988	7101	142020	32886.3	60445.8	44001
1989	9781	166330	40666.3	69571.7	63606

Sources: Country Chapter for Indonesia and ***SEACEN Financial Statistics***, various issues.

Korea
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Billion Won)

Year	Total Long-term Financing for Agriculture and Manufacturing	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1980	2065.9	38041.1	10419.7	16975.9	17264.7
1981	2683.1	47482.0	13885.4	21629.2	22765.7
1982	3335.5	54442.8	14759.2	23896.8	28637.7
1983	3968.2	63832.8	18064.6	27783.7	34540.8
1984	4528.1	72644.3	21240.8	31767.4	42307.5
1985	5453.4	80846.9	23018.1	34882.4	50674.1
1986	7523.4	93423.8	29866.3	40308.0	59553.0
1987	9192.3	108428.3	37919.4	46256.6	68601.5
1988	10969.4	127962.7	43457.5	55111.2	79125.3
1989	12558.1	142266.8	41141.6	59006.2	102628.6
1990	15139.7	169701.4	45302.4	64943.6	125201.2

Sources: Country Chapter for Korea and ***SEACEN Financial Statistics***, various issues.

Malaysia
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Ringgit)

Year	Total Long-term Financing for Agriculture and Manufacturing	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1980	4299.7	44511	28172.0	18932	29367
1981	5437.2	47601	27109.0	19839	36528
1982	6828.8	50445	28108.0	21066	43340
1983	8217.5	53583	32771.0	21731	54047
1984	8972.2	57742	38647.0	23335	64675
1985	9493.7	57093	38017.0	23117	73391
1986	10047.0	57751	35721.0	24459	77858
1987	10574.9	60863	45138.0	26950	77947
1988	12228.8	66303	55260.0	30084	85226
1989	14250.3	72435	67836.0	33211	100820
1990	17716.8	79551	78326.0	36161	123343

Sources: Country Chapter for Malaysia and ***SEACEN Financial Statistics,*** various issues.

Nepal
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Rupees)

Year	Total Long-term Financing for Agriculture and Manufacturing	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1980/81	824.4	27307	1608.7	27317	3758.6
1981/82	658.0	30988	1491.5	30988	3427.7
1982/83	1042.3	33761	1132.0	33761	3782.9
1983/84	1110.6	39390	1703.9	39390	4041.7
1984/85	1660.6	44417	2740.6	44417	5196.0
1985/86	2666.5	50428	3078.0	50428	6755.0
1986/87	2945.4	59296	2991.4	59246	7691.7
1987/88	4139.6	69513	4114.5	69523	9175.5
1988/89	5420.6	77144	4195.3	77414	11484.8
1989/90	6671.1	84911	4235.5	84911	13457.1

Sources: Country Chapter for Nepal and ***SEACEN Financial Statistics***, various issues.

Philippines
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Pesos)

Year	Total Long-term Financing for Agriculture and Manufacturing 1/	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1980	3868	243749	43476	123873	81518
1981 2/	3547	281596	45202	141921	95893
1982	5785	317177	42879	153663	105529
1983 3/	3280	369077	55619	172017	78844
1984	2757	524481	90023	258995	79882
1985	3210	571883	86133	284405	60563
1986	3225	608887	98707	295765	61382
1987	2226	685068	117647	333554	83618
1988	2708	802519	149224	390243	107292
1989	2818	925161	170003	443201	150489
1990	2078	1070900	199006	503441	209413

1/ Represents loans outstanding of commercial banks, savings banks, and specialized government banks (except the Development Bank of the Philippines) with maturities of over five years.

2/ Based on 1st quarter 1982 data.

3/ Based on 1st quarter 1984 data.

Sources: Country Chapter for Philippines and ***SEACEN Financial Statistics,*** various issues.

Sri Lanka
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Rupees)

Year	Total Long-term Financing for Agriculture and Manufacturing	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1980	513	62246	17595	28199	5725
1981	528	79337	21043	34860	4433
1982	446	93194	21454	38565	4764
1983	636	111976	25096	48138	6667
1984	1090	138173	37347	62038	4466
1985	1108	148321	36207	62918	4463
1986	1501	163713	34072	69224	4348
1987	1890	177731	41133	76393	9330
1988	2575	203516	46928	84898	11272
1989	2738	228138	56175	93403	11659
1990	3185	290495	79481	119632	17682

Sources: Country Chapter for Sri Lanka and ***SEACEN Financial Statistics,*** various issues.

Thailand
TOTAL LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Baht)

Year	Total Long-term Financing for Agriculture and Manufacturing 1/	GDP at Current Price	Total Exports	Value Added in the two Sectors	Total Loans
1985	4992	1014000	193366	399700	521036.0
1986	3195	1095400	233383	428500	543728.5
1987	4349	1253200	299853	504900	672906.8
1988	5641	1507000	403570	623700	853545.4
1989	7883	1776000	516315	719700	110596.2
1990	7925	2086800	589813	816800	1481953.7

1/ Long-term loans from Industrial Finance Corporation of Thailand (IFCT) and the Bank for Agriculture and Agricultural Cooperatives (BAAC).

Sources: Country Chapter for Thailand and ***SEACEN Financial Statistics***, various issues.

Indonesia
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Billion Rupiah)

Year	Long-term Financing		GDP at	Total	Value	Value	Total
	Agriculture	Manufacturing	Current Price	Exports (fob)	Added Agriculture	Added Manufacturing	Loans
1979	134	669	32005	9713.5	8995.7	3310.6	6268
1980	173	950	45446	15016.4	11290.3	5287.9	7880
1981	312	1210	58127	15898.2	13642.5	5821.7	10159
1982	429	1716	62476	14768.2	15668.3	7680.7	13022
1983	556	2221	77623	19227.2	17696.0	8211.0	15299
1984	629	2486	89885	22455.8	20334.0	11082.0	18813
1985	945	2867	96997	20642.4	22413.0	12904.0	22157
1986	1292	3098	102683	18463.8	24696.0	13585.0	26402
1987	1690	3567	124817	28284.1	29116.0	21150.0	32852
1988	2284	4817	142020	32886.3	34278.0	26252.0	44001
1989	3357	6424	166330	40666.3	39164.0	30323.0	63606

Sources: Country Chapter for Indonesia and ***SEACEN Financial Statitsics,*** various issues.

Korea
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Billion Won)

Year	Long-term Financing: Agriculture	Long-term Financing: Manufacturing	GDP at Current Price	Total Exports	Value Added in Agriculture	Value Added in Manufacturing	Total Loans
1980	439.5	1626.4	38041.1	10419.7	5677.4	11298.5	17264.7
1981	593.9	2089.2	47482.0	13885.4	7430.6	14198.6	22765.7
1982	748.2	2586.2	54442.8	14759.2	7989.2	15907.6	28637.7
1983	1049.7	2918.5	63832.8	18064.6	8678.2	19105.5	34540.8
1984	1347.2	3180.9	72644.3	21240.8	9392.1	22375.3	42307.5
1985	1608.2	3845.2	80846.9	23018.1	10351.8	24530.4	50674.1
1986	1833.1	5960.3	93423.8	29866.3	10728.6	24579.4	59553.0
1987	2082.9	7109.4	108428.3	37919.4	11353.3	34903.3	68601.5
1988	2634.5	8334.9	127962.7	43457.5	13493.9	41617.3	79125.3
1989	3110.4	9547.7	142266.8	41141.6	14457.8	44650.0	102628.6
1990	3754.4	11385.3	169701.4	45302.4	15583.5	49894.0	125201.2

Sources: Country Chapter for Korea and ***SEACEN Financial Statitsics,*** various issues.

Malaysia
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Ringgit)

Year	Long-term Financing		GDP at Current Price	Total Exports	Value Added in Agriculture	Value Added in Manufacturing	Total Loans
	Agriculture	Manufacturing					
1980	2859.4	1440.3	44511	28172	10932.0	8000.0	29367
1981	3467.9	1969.3	47601	27109	10349.2	9489.8	36528
1982	4527.7	2301.0	50445	28108	12542.7	8523.3	43340
1983	5221.1	2996.4	53583	32771	12347.7	9383.3	54047
1984	5918.8	3053.4	57742	38647	11033.7	12301.3	64675
1985	6312.0	3181.7	57093	38017	11001.6	12115.4	73391
1986	6700.9	3346.1	57751	35721	12304.6	12154.4	77858
1987	6993.9	3581.0	60863	45138	13632.7	13317.3	77947
1988	7479.5	4749.3	66303	55260	13825.4	16258.6	85226
1989	8022.5	6227.8	72435	67836	12619.3	20591.7	100820
1990	9192.9	8523.9	79551	78326	11631.4	24529.6	123343

Sources: Country Chapter for Malaysia and ***SEACEN Financial Statistics,*** various issues.

Nepal
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Rupees)

Year	Long-term Financing		GDP at Current Price	Total Exports	Values Added		Total Loans
	Agriculture	Manufacturing			Agriculture at Current Price	Non Agriculture at Current Price	
1980/81	165.6	658.8	27307	1608.7	15510	1049	3758.6
1981/82	314.0	344.0	30988	1491.5	17715	1243	3427.7
1982/83	420.3	622.0	33761	1132.0	19082	1460	3782.9
1983/84	594.1	516.5	39390	1703.9	22570	1816	4041.7
1984/85	729.4	931.2	44417	2740.6	23927	1998	5196.0
1985/86	812.7	1853.8	50428	3078.0	20555	2622	6755.0
1986/87	764.0	2181.4	59296	2991.4	30448	3065	7691.7
1987/88	1407.2	2732.4	69513	4114.5	35477	3646	9175.5
1988/89	2174.8	3245.8	77144	4195.3	40889	3619	11484.8
1989/90	2689.7	3981.4	84911	4235.5	47251	4775	13457.1

Sources: Country Chapter for Nepal and ***SEACEN Financial Statistics,*** various issues.

Philippines
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS 1/

(Million Pesos)

Year	Long-term Financing: Agriculture	Long-term Financing: Manufacturing	GDP at Current Price	Total Exports	Value Added in Agriculture	Value Added in Manufacturing	Total Loans
1980	1072	2796	243749	43476	61219	62654	81518
1981 2/	1245	2302	281596	45202	70092	71829	95893
1982	1979	3806	317177	42879	74055	79608	105529
1983 3/	1660	1620	369077	55619	82545	89472	78844
1984	1013	1744	524481	90023	129824	129171	79882
1985	1440	1770	571883	86133	140554	143851	60563
1986	833	2392	608887	98707	145807	149958	61382
1987	633	1593	685068	117647	163927	169627	83618
1988	1038	1670	802519	149224	183515	206728	107292
1989	1567	1251	925161	170003	210009	233192	150489
1990	975	1103	1070900	199006	235956	267485	209413

1/ Represents loans outstanding of commercial banks, savings banks, and specialized government banks (except the Development Bank of the Philippines) with maturities of over five years.
2/ Based on 1st quarter 1982 data.
3/ Based on 1st quarter 1984 data.

Sources: Country Chapter for Philippines and ***SEACEN Financial Statistics,*** various issues.

Sri Lanka
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Rupees)

Year	Long-term Financing		GDP at Current Price	Total Exports	Value Added in Agriculture	Value Added in Manufacturing	Total Loans
	Agriculture	Manufacturing					
1980	103	410	62246	17595	17900	12422	5725
1981	7	521	79337	21043	22787	14028	4433
1982	8	438	93194	21454	25258	14644	4764
1983	137	499	111976	25096	30468	17933	6667
1984	136	954	138173	37347	37293	24301	4466
1985	194	914	148321	36207	38505	21180	4463
1986	360	1141	163713	34072	39529	26913	4348
1987	848	1024	177731	41133	43174	29701	9330
1988	521	2054	203516	46928	51074	34852	11272
1989	577	2161	228138	56175	56774	41415	11659
1990	644	2541	290495	79481	72788	54943	17682

Sources: Country Chapter for Sri Lanka and ***SEACEN Financial Statistics,*** various issues.

Thailand
LONG-TERM FINANCING FOR AGRICULTURE AND MANUFACTURING TO GROSS DOMESTIC PRODUCT (GDP), TOTAL EXPORTS, VALUE ADDED AND TOTAL LOANS

(Million Baht)

Year	Long-term Financing: Agriculture 1/	Long-term Financing: Manufacturing 2/	GDP at Current Price	Total Exports	Value Added in Agriculture	Value Added in Manufacturing	Total Loans
1985	1985	3007	1014000	193366	175200	224500	521036.0
1986	1745	1450	1095400	233383	169900	258600	543728.5
1987	2085	2264	1253200	299853	205600	299300	672906.8
1988	3364	2277	1507000	403570	250400	373300	853545.4
1989	4532	3351	1776000	516315	266400	453300	1110596.2
1990	4394	3531	2086800	589813	265600	551200	1481953.7

1/ Long-term loans from the Bank for Agriculture and Agricultural Cooperatives (BAAC).
2/ Long-term loans from Industrial Finance Corporation of Thailand (IFCT).

Sources: Country Chapter for Thailand and ***SEACEN Financial Statistics***, various issues.

Part II

COUNTRY STUDIES:

INDONESIA
KOREA
MALAYSIA
NEPAL
PHILIPPINES
SRI LANKA
THAILAND

Chapter 6

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN INDONESIA

by

Ellys Yudhiatie and Haerani Rusland

I. An Overview of the Existing Conditions of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Nature of Long-Term Financing for Manufacturing and Agricultural Sectors

Indonesia is one of the developing countries which manufacturing and agricultural sectors play an important role in her economy. The roles of the manufacturing and agricultural sectors are reflected in their share to gross domestic product (GDP) in Table 6.1 as well as against the non-oil/gas exports in Table 6.2. Accordingly, the Indonesian strategic plan, namely the Five Year Development Plan of Indonesia, has stated that a substantial part of the country resources for economic development has to be derived from manufacturing and agriculture.

Table 6.1

SECTORAL SHARES IN REAL GDP

(Percentage)

Sector	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
1. Agriculture	32.0	30.7	29.8	29.8	22.9	22.3	22.7	22.0	21.4	21.2	20.6
2. Mining and Quarrying	20.3	9.3	8.9	7.6	20.8	20.6	18.2	18.1	17.3	15.9	15.6
3. Manufacturing	13.7	15.3	15.6	15.4	12.7	14.5	15.8	16.3	5.1	18.2	18.5
4. Construction	5.5	5.7	6.0	6.1	5.9	5.3	5.3	5.1	5.2	5.3	5.5
5. Transportation and Communication	5.5	5.5	5.6	5.8	5.3	5.4	5.3	5.2	0.5	5.2	5.3
6. Electricity, gas and water supply	0.7	0.7	0.7	0.9	0.4	0.4	0.4	0.5	15.2	0.5	0.6
7. Trade, hotel and restaurant	16.5	16.6	16.6	17.5	14.7	14.2	14.6	14.9	3.9	15.7	16.1
8. Banking and other financial intermediaries	1.8	1.9	1.9	2.1	3.0	3.4	3.5	3.9	n.a.	3.8	4.0
9. Ownership of dwelling	3.0	3.0	3.0	3.1	3.0	2.9	2.9	2.8	2.8	2.8	2.7
10. Public administration and defence	7.9	8.7	8.7	9.0	7.4	7.2	7.6	7.6	7.8	7.9	7.8
11. Other services	3.0	2.8	2.8	2.6	3.9	3.8	3.7	3.7	3.6	3.6	3.5
G D P	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bureau of Statistics.

Table 6.2

SHARES OF THE AGRICULTURAL AND MANUFACTURING EXPORTS

(Percentage)

Group of Commodities	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Share to non-oil/gas export:											
1. Agricultural sector	83.5	77.8	69.8	68.8	67.9	44.7	41.5	42.2	35.8	33.0	25.7
2. Mining sector	11.3	16.7	22.6	18.6	15.5	13.5	13.5	11.0	11.1	11.9	12.0
3. Manufacturing sector	5.2	5.5	7.6	12.6	16.6	41.8	45.0	46.8	53.1	55.1	62.3
Share to oil/gas export:											
1. Agricultural sector	29.3	20.9	13.1	13.5	18.0	12.4	13.4	19.5	17.9	19.7	15.7
2. Mining sector	4.0	4.5	4.2	3.7	4.1	3.8	4.3	5.1	5.6	7.1	7.3
3. Manufacturing sector	1.8	1.5	1.4	2.5	4.4	11.6	14.5	21.6	26.7	33.0	38.1

Source: Central Bureau of Statistics.

The share of the agricultural and manufacturing sectors as a proportion of Gross Domestic Product during 1979-1989 recorded an average of 27.5 per cent and 17.3 per cent, respectively. The share of agricultural sector had decreased from 32 per cent at the end of 1979 to 20.6 per cent at the end of 1989. As for manufacturing sector, the share had been increasing in the early 1980s, slowing down in 1983 and 1984 and started increasing again from 1985 onwards to 18.5 per cent at the end of 1989.

The share of agricultural sector's exports to overall non-oil/gas exports was around 53.6 per cent during 1979-1989, and that of the manufacturing sector was around 7.7 per cent in the early 1980s, but increased to around 52.5 per cent during the later part of the 1980s (Table 6.2). The important role of the manufacturing sector can also be seen from the growth rate of its export during the period of the study. There was a significant decrease in the agricultural sector export at an average of 0.5 per cent, and in contrast a remarkable increase in the manufacturing sector at an average of 47.3 per cent during 1979-1989 (Table 6.3).

Banking institutions and non bank financial institutions are the principal institutions which play a major role in financing the manufacturing and agricultural sectors in Indonesia. Indonesia's financial system includes banks, security houses as well as leasing and insurance companies.

Table 6.3

GROWTH RATES OF THE AGRICULTURAL AND MANUFACTURING EXPORTS

(Percentage)

Year	Rate Increase			
	Total Non-Oil/Gas Exports	Agricultural Exports	Manufacturing Exports	Other Export
1979	-	-	-	-
1980	9.0	1.6	16.2	60.0
1981	-27.1	-35.9	-0.6	5.3
1982	-12.5	-12.0	46.0	-32.3
1983	28.8	27.2	69.3	7.1
1984	15.7	-23.9	191.4	0.8
1985	3.5	-4.0	11.6	3.3
1986	11.3	13.1	15.6	-8.3
1987	29.7	10.0	47.4	30.2
1988	35.2	24.7	40.4	44.4
1989	20.4	-6.1	36.1	21.1
Average during 1979-1989	11.4	-0.5	47.3	13.2

Source: Central Bureau of Statistics.

Banks include state commercial banks (SCBs), state development bank, state owned savings bank, private commercial banks (PCBs), private cooperative banks, foreign banks, joint venture banks and small rural non-deposit-money banks. As of end-1993, there were 234 banks operating in Indonesia, which consisted of seven state commercial banks, 188 private commercial banks and 39 joint venture banks. There was also a large number of small rural banks. Other financial institutions included 145 insurance companies, 58 leasing companies and a number of pawn shops. Commercial banking is dominated by five major state owned banks, namely, Bank Rakyat Indonesia (BRI), Bank Bumi Daya (BBD), Bank Negara Indonesia (BNI), Bank Dagang Negara (BDN) and Bank Eksim.

Besides the banking institutions, two development finance companies dealing with long term financing for manufacturing and agricultural sectors are the Indonesian Development Finance Company (IDFC/UPPINDO) and the Private Development Finance Company (PDFCI).

With the financial reform of June 1983 which was aimed at encouraging banks to maximize the mobilization of funds from the public, the state banks can manage their portfolio in any sectors of the economy and free to compete in the market alongside with other banks.

Table 6.4 depicts the development of financing for both agricultural and manufacturing sectors during 1979-1989. The table shows that the average growth of long-term financing for both sectors (28.8 per cent) was higher than that of short-term financing (26.6 per cent).

Table 6.4

LONG-TERM AND SHORT-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS

(Billion Rupiah)

Year	Outstanding Balance			
	Long-term Financing		Short-term Financing	
1979	803.0		1568.0	
1980	1123.0	(39.8%)	1976.0	(26.0%)
1981	1522.0	(35.5%)	2615.0	(32.3%)
1982	2145.0	(40.9%)	3597.0	(37.5%)
1983	2777.0	(29.5%)	3656.0	(1.6%)
1984	3115.0	(12.2%)	4870.0	(33.2%)
1985	3812.0	(22.4%)	5436.0	(11.6%)
1986	4390.0	(15.2%)	6712.0	(23.5%)
1987	5257.0	(19.7%)	8316.0	(23.9%)
1988	7101.0	(35.1%)	11465.0	(37.9%)
1989	9781.0	(37.7%)	15835.0	(38.1%)
Average annual rate of increase for 1979-1989		(28.8%)		(26.6%)

Note: Figures in parentheses represent annual rate of increase.

Source : Bank Indonesia

Observing the average growth rate of long-term financing for both sectors in Table 6.5, we find that the average growth rates of long-term financing for agricultural (38.9 per cent) and manufacturing (25.9 per cent) sectors, were higher than that of total financing for both sectors, namely 28.9 per cent for agricultural sector and 22.9 per cent for manufacturing sector.

Table 6.5

LONG-TERM FINANCING V.S. TOTAL FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS 1/

(Billion Rupiah)

Year	Long-term Financing 1/						Total Financing						A/D	B/E	C/F
	Agricultural Sector A		Manufacturing Sector B		All Sector C		Agricultural Sector D		Manufacturing Sector E		All Sector F		(%)	(%)	(%)
1979	134	(4.7%)	669	(23.6%)	2830	(100%)	438	(7.0%)	1933	(30.8%)	6268	(100%)	30.6	34.6	45.1
1980	173	(5.3%)	950	(29.1%)	3267	(100%)	526	(6.7%)	2563	(32.5%)	7880	(100%)	32.9	37.1	41.5
1981	312	(8.3%)	1210	(32.0%)	3777	(100%)	813	(8.0%)	3324	(32.7%)	10159	(100%)	38.4	36.4	37.2
1982	429	(9.7%)	1716	(38.9%)	4416	(100%)	1025	(7.9%)	4717	(36.2%)	13022	(100%)	41.6	36.4	33.9
1983	556	(11.0%)	2221	(44.1%)	5041	(100%)	1226	(8.0%)	5207	(8.0%)	15299	(100%)	45.4	42.7	32.9
1984	629	(11.7%)	2486	(46.3%)	5367	(100%)	1318	(7.0%)	6667	(35.4%)	18813	(100%)	47.7	37.3	28.5
1985	945	(14.5%)	2867	(44.1%)	6499	(100%)	1656	(7.4%)	7592	(34.3%)	22157	(100%)	57.1	37.8	29.3
1986	1292	(16.9%)	3098	(40.6%)	7630	(100%)	2097	(7.9%)	9005	(34.1%)	26402	(100%)	61.6	34.4	28.3
1987	1690	(18.8%)	3567	(39.7%)	8982	(100%)	2656	(8.1%)	10917	(33.2%)	32852	(100%)	63.6	32.7	27.3
1988	2284	(19.1%)	4817	(40.2%)	11969	(100%)	3610	(8.2%)	14956	(34.0%)	44001	(100%)	63.3	32.2	27.3
1989	3357	(22.5%)	6424	(43.1%)	14908	(100%)	5283	(8.3%)	20333	(32.0%)	63606	(100%)	63.5	31.6	23.4
Average during 1979-1989%	38.9 %		25.9 %		18.3 %		28.9 %		22.9 %		26.3 %		-	-	-

1/ Figures in parentheses represent the share of that sector in all sector.

Source: Bank Indonesia

The ratio of long-term financing for agricultural sector to aggregate long-term financing to all sectors increased from 4.7 per cent as at the end of 1979 to 22.5 per cent as at the end of 1989. That of the manufacturing sector also increased significantly from 23.6 per cent in 1979 to 46.3 per cent as at the end of 1984 but decreasing slightly from 1985 onwards to stand at 43.1 per cent as at the end of 1989.

The share of total financing to the agricultural sector in aggregate financing to all sector as at the end of 1989 was 8.3 per cent much less than the share of long-term financing of this sector to total long-term financing which recorded 22.5 per cent. The manufacturing sector's share in aggregate financing to all sector as at the end of 1989 was 32.0 per cent which was also lower than its 43.1 per cent share in term of its share in long-term financing. For all sectors, the ratio of long-term financing to all type of financing averaged between 23.4 per cent to 45.1 per cent during 1979 - 1989. At the end of 1989, the long-term financing for agricultural sector accounted for around 64 per cent of all financing to all sectors whereas for manufacturing sector it accounted for about 32 per cent.

Table 6.6 presents the proportional share of long-term financing for agriculture and manufacturing sectors to GDP, to total non-oil/gas export and to its value added.

Table 6.6

RATIO OF LONG-TERM FINANCING FOR THE TWO SECTORS TO GDP, TOTAL NON-OIL/GAS EXPORT, AND VALUE ADDED IN THE TWO SECTORS

(Billion Rupiah)

Year-end	Aggregate Long-term Financing for the Two Sectors (A)	GDP (B)	Total Non-Oil/Gas Export (C)	Value Added in the Two Sector (D)	A/B	A/C	A/D
1979	803	32,005.0	3,476.1	12,306.3	2.5	23.1	6.5
1980	1123	45,446.0	3,811.5	16,578.2	2.5	29.1	6.8
1981	1522	58,127.0	2,799.3	20,764.9	2.6	54.4	7.3
1982	2145	62,476.0	2,565.0	22,544.5	3.4	83.6	9.5
1983	2777	77,623.0	4,540.1	27,661.1	3.6	61.2	10.0
1984	3115	89,885.0	5,924.6	33,532.6	3.5	52.6	9.3
1985	3812	96,997.0	6,639.2	38,016.2	3.9	57.4	10.0
1986	4390	102,683.0	8,537.0	42,055.6	4.3	51.4	10.4
1987	5257	124,817.0	14,194.2	50,266.4	4.2	37.0	10.5
1988	7101	142,020.0	19,683.9	60,445.8	5.0	36.1	11.8
1989	9781	166,330.0	24,887.6	69,571.7	5.9	39.3	14.1

Source: Bank Indonesia

The ratio of long-term financing for the two sectors to GDP and value added increased steadily during 1979-1989. Its ratio to total non-oil/gas export was sharply increased during the early 1980s but had decreased since 1983.

1.2 Sources of Long-Term Financing

With the onset of financial reforms, the State Commercial Banks (SCB) are being challenged to mobilize more lending, and also allowed to manage their portfolio apart from the designated sectors of the economy. Although they have started to diversify and lend to all sectors of the economy, their loan portfolios still reflect their original specialization. For the above reasons and due to a lack of data we can observe the ratio and the source of long-term financing for agricultural and manufacturing sectors according to the original specialization of 3 SCBs, and 1 development finance company; BRI specializes in agriculture (primarily small-holdings), Bank Exim finances the production and export of agricultural and manufacturing commodities, Bapindo finances the medium/long-term loans for mainly manufacturing projects and PT. PDFCI a development finance company.

We will examine these institutions by dividing its amount of long-term financing outstanding and sources of funds as at end of 1980, 1985 and 1989/1990. It is noted that until 1985 their loan/credit portfolios still reflect their specialization and its sources of funds relied on liquidity credit from Bank Indonesia. But after the financial reform of 1983 and 1988 their loan/credit portfolios began to reflect the diversification and its sources of funds was replaced by public funds. The share of long-term financing for agricultural and manufacturing sector to total long- term financing by BRI and Bank Exim had been shifting. As of end of 1980 and 1985 the share of the long-term financing for agricultural sector in aggregate long-term financing by BRI was larger than that of manufacturing sector, but its share decreased from 16.9 per cent at end of 1985 to 11.58 per cent as at end of 1989, whereas the share of manufacturing sector increased from 5.8 per cent at end of 1985 to 17.89 per cent at end of 1989. On the contrary, the share of agricultural sector in aggregate long-term financing by Bank Exim increased from 33.08 per cent at end of 1985 to 41.39 per cent at end of 1989 (Table 6.7).

Looking at the sources of funds of these banks, the principal sources of funds of BRI (Table 6.8) consist of deposits and borrowings from Bank Indonesia. The share of deposits shows an upward trend making up 50.79 per cent of the total at end of 1989, whereas borrowings from Bank Indonesia decreased from 52.54 per cent at end of 1985 to 38.20 per cent at end of 1989.

Table 6.7

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS

	Agricultural Sector						Manufacturing Sector					
	1980		1985		1989		1980		1985		1989	
	amount 1/	% of total 2/	amount 1/	% of total 2/	amount 1/	% of total 2/	amount 1/	% of total 2/	amount 1/	% of total 2/	amount 1/	% of total 2/
BRI	1154	(16.36)	1129	(16.9)	17987	(11.58)	818	(11.64)	391	(5.8)	27788	(17.89)
BANK EXIM	1343	(9.19)	21616	(33.08)	68260	(41.39)	506	(34.62)	227	(34.74)	42961	(26.05)
BAPINDO	-	-	-	-	-	-	9848	(58.89)	5002	(72.47)	14386	(74.33)
PDFCI	-	-	-	-	-	-	-	-	1470	(91.80)	1081	(94.50)

1/ Amount in billion rupiah.
2/ Sectoral shares (percentage) in aggregate long term financing by each institution.

Sources: BRI, Bank Exim, BAPINDO and PDFCI Annual Reports.

Table 6.8

SOURCES OF FUNDS OF BRI

(Unit in Billion Rupiah, %)

	Year end 1980		Year end 1985		Year end 1989	
	amount	% of total	amount	% of total	amount	% of total
Deposits	789.20	62.92	1,915.20	34.12	6,249.00	50.79
Borrowings from						
B.I	391.20	30.84	2,948.70	52.54	4,699.67	38.20
Government	71.20	5.61	104.30	1.87	88.33	0.72
Foreign	7.90	0.63	-	-	986.27	8.00
BRI's funds	-	-	119.10	2.12	3.85	0.04
Other	-	-	524.60	9.35	275.50	2.25
	1,268.50	100.00	5,611.90	100.00	12,302.62	100.00

Source: BRI Annual Reports.

In the case of Bank Exim (Table 6.9), in 1980 the main sources of its funds were deposits (53.72 per cent) and foreign borrowings (29.58 per cent), but as end of 1985 and 1989 deposits (81.62 per cent and 72.20 per cent) and borrowing from Bank Indonesia (12.41 per cent and 16.57 per cent) had become more prominent, whereas for PDFCI (Table 6.10) as a development financial institution, had to rely its sources of funds on borrowing from Bank Indonesia.

Table 6.9

SOURCES OF FUNDS OF BANK EXIM

(Unit in Billion Rupiah, %)

	Year end 1980		Year end 1985		Year end 1989	
	amount	% of total	amount	% of total	amount	% of total
Deposits	477.30	53.72	2,286.70	81.62	5,472.21	72.20
Borrowings from						
B.I	136.90	15.42	347.77	12.44	1,257.53	16.57
Government	-	-	-	-	-	-
Foreign	262.90	29.58	-	-	205.61	2.70
Others	-	-	139.53	4.99	1.35	0.03
Other	11.30	1.28	27.70	0.95	645.00	8.50
	888.40	100.00	2,801.70	100.00	7,581.70	100.00

Source: Bank Exim Annual Reports.

Table 6.10

SOURCES OF FUNDS OF PDFCI

(Unit in Billion Rupiah, %)

	Year end 1985		Year end 1989	
	amount	% of total	amount	% of total
Borrowings from				
Government	11.89	13.00	114.28	24.90
B.I	66.87	73.6	200.76	43.70
Foreign	0.35	0.80	53.96	11.80
Shareholder's fund	11.59	12.60	90.09	19.60
	90.70	100.00	459.09	100.00

Source: PDFCI Annual Reports.

Until the mid-1980s, Bapindo had relied for its sources of funds on borrowings from Bank Indonesia (45.30 per cent), but following the financial reform of 1988 this source was largely replaced by deposits which increased dramatically from only 13.50 per cent at end of 1985 to 34.60 per cent at end of 1990.

Table 6.11

SOURCES OF FUNDS OF BAPINDO

(Unit in Billion Rupiah, %)

	Year end 1980		Year end 1985		Year end 1989	
	amount	% of total	amount	% of total	amount	% of total
Deposits	30.40	12.00	162.70	13.50	1,228.20	34.60
Borrowings from						
B.I	52.80	20.80	546.30	45.30	1,183.20	33.30
Government	32.60	12.90	153.60	12.70	71.10	2.00
Foreign	51.60	20.40	117.10	9.70	412.10	11.60
Others	9.70	4.00	35.00	3.00	302.70	8.50
Equity	75.80	29.90	191.00	15.80	354.80	10.00
	252.90	100.00	1,205.70	100.00	3,552.10	100.00

Source: BAPINDO Annual Reports.

1.3 Lending Policies and Procedures

The state owned commercial banks (SCBs) including state development bank and the development finance companies are the major long term financing institutions for the manufacture and agricultural sectors.

During 1983-1990 the major instrument of credit policy was rediscount credit to priority sectors (called liquidity credits). Banks, especially SCBs, were induced to provide loans to selected priority sectors at below market interest rate set by Bank Indonesia (BI) and these loans were eligible for liquidity credits from Bank Indonesia at varying rediscount proportion depending upon the type of loan.

The extension of central bank liquidity credits had already been in place since 1979 and it rose by an average of 40 per cent per year. The growth of liquidity credits induced the development of priority sectors through channelling the funds to selected borrowers and priority government programs in agriculture and manufacturing sectors.

The financial reform of June 1983 was aimed at encouraging banks to maximize the mobilization of funds from the public and reducing banks' dependence on the liquidity credit from Bank Indonesia. Interest rate controls on SCBs were eliminated; the liquidity credit mechanism was simplified by phasing out a wide range of loans categories from access to liquidity credits eventhough it still constituted about 23 credit categories (Table 6.12).

The policies and procedures on application for long-term financing for agricultural and manufacturing sectors are set by financial institutions on the basis of guidelines issued by the central bank. Based on the guidelines issued by Bank Indonesia in its circular letters, they have the authority to set terms and procedures on loans to be extended taking into account several factors, namely:

- self financing capability;
- project feasibility - financial statement;
- investment negative list (from the Indonesian Investment Coordinating Agency); and,
- in the case of an already-established firm or firm which has already engaged in other business and has previously received credit, a scrutiny has to be made to ensure whether the firm is categorized as delinquent.[1]

If a firm meets the above requirements, and a principal approval has been issued, the prospective borrower is required to submit a feasibility study for an assessment by the bank or institution concerned.

In case the Board considers the project as feasible, an approval for the loan will be issued. In order to apply for liquidity credit, the handling bank passes on the result of its project assessment to Bank Indonesia.

1/ Bank Indonesia Circular Letter No. 16/1/UKU, June 1, 1983.

Table 6.12

PRIORITY CREDIT SCHEMES EXTENDED BETWEEN 1983-1990

	Bank Credit Int 1/	SF 2/	Liquidity Credit Amount	Int	Economic Sector	Financial Institutions	Term 3/ (years)
I. WORKING CAPITAL CREDIT							
1. Credit to farmers through KUDs for the intensification of foodcrops	12%	0%	100%	3%	agriculture	BRI	1
2. Permanent Working Capital Credit	12%	0%	55%	5.2%	all	State & Private Banks	5
3. Credit for production, import and distribution of fertilizer and pesticide	12%	25%	75%	3%	agriculture	State & Private Banks	
4. Credit to private national plantation (PSN)	12%	30%	75%	3%	agriculture	State & Private Banks	1
5. Credit to cooperatives 6/	12%	0%	90%	3%	agriculture	State & Private Banks	1
6. Export credit 7/	12%	15%	60%	3%	all	State & Private Foreign	1
7. Working Capital Credit under Presidential Decree no. 29/1984	12%	10%	70%	3%	all/constructions	State & Private Banks	1
8. Credit for national contractors	9%	30%	70%	3%	constructions	State & Private Banks	1
9. General Rural credit (KUPEDES)	18%	0%	100%	12%	all/rural area	BRI	2
10. Working Capital Credit with a Maximum of Rp. 75 million	15%	10%	70%	3%	all	State & Private Banks	1
II. INVESTMENT CREDIT							
1. General rural credit (KUPEDES)	12%	0%	100%	12%	all/rural area	BRI	3
2. Small investment credit	12%	0%	55%	5.2%	all	State & Private Banks	8
3. Plantation Credit to:							
a. Nucleus Smallholder Estate (PIR)	12%	0%	80%	3%	agriculture	BRI,BBD,BEII	20
b. Replanting, rehabilitation and expansion of export commodity crops (PRPTE).	12%	0%	80%	3%	agriculture	State & Private Banks	20
c. Private national estate (PSN)	12%	10%-30%	85%	3%	agriculture	State & Private Banks	16 5/
d. Transmigrants smallholder estate (PIRTRANS)	16%	35%	55%	6.5%	agriculture	State & Private Banks	20
4. Investment credit with maximum of Rp. 75 million	15%	10%	70%	3%	agriculture	State & Private Banks	10
5. Credit to cooperatives 6/	12%	0%	90%	3%	agriculture	State & Private Banks	10
6. Credit for paddy field formation	12%	0%	100%	3%	agriculture	State & Private Banks	2
III. OTHERS							
1. House ownership credit (KPR)	9-15%	10%-20%	75-90%	3%	housing	BTN	20
2. Credit for Indonesian student	6%	0%	100%	3%		BNI'46	7
3. Credit for student dormitories	5%	0%	80%	3%	constructions	BTN	20
4. Credit for teachers	12%	10%	60%	3%	services	State & Private Banks	5
(for motorcycle ownership)			65%	3%	services		

1/ Interest charged by handling banks to customers.

2/ Minimum percentage of customer's self financing against the total cost needed.

3/ Maximum maturity.

4/ Flat rate.

5/ Maximum maturity depend on the kind of commodity.

6/ Credit for its members and for purchasing essential commodities.

7/ Lately the credit interest is freely determined by respective handling bank and the share of liquidity credit became 60%-85%.

In Bank Indonesia the management of liquidity credit is handled by two departments, namely General Credit Department and Cooperative and Small-scale Credit Department with the objective to provide recommendation and up-to-date information needed in the implementation of the liquidity credit (Kredit Likuiditas B.I. or KLBI). These two departments analyze liquidity credit application regarding legal, technical, management, marketing and financial aspects as well as updating data on the realization of KLBI.

In general, long-term financing for the agricultural and manufacturing sectors is not covered by an idemnity insurance. On a case-by-case basis, however the risk against default can be insured, especially for priority loans or long-term loans partly financed by foreign sources or government borrowing. For example, for a long-term loans for financing special projects containing external sources, the risk against default is covered by the Government (50 per cent), Bank Indonesia (25 per cent) and the State Commercial Bank (25 per cent).

Priority credit/special credit is eligible for insurance through Perusahaan Umum Pengembangan Keuangan Koperasi or Perum PKK, a government corporation for the financial development of cooperatives engaged in indemnity insurance with the main task of covering risk on credits extended by banks to cooperatives. Another financial institution engaged in indemnity insurance is PT Asuransi Kredit Indonesia (PT Askrindo), with functions primarily to provide insurance for small-scale investment credits (Kredit Investasi Kecil or KIK) and permanent working capital credits (Kredit Modal Kerja Permanen or KMKP).

II. The Role of Central Bank in Long-Term Financing for Manufacturing and Agricultural Sectors

2.1 Financing Facilities of the Central Bank

It has been noted that most central banks in South East Asian have taken credit-policy measures, such as:

- refinancing on priority agricultural and manufacturing sectors at low rates of interest varying from 3 per cent to 14.5 per cent;

- guarantee of default on loans;
- establishment of specialized credit programs and credit insurance schemes;
- supervision and promotion of rural banking; and,
- obtaining international financing for various sectors including agricultural and manufacturing.

Bank Indonesia as the central bank is responsible for the implementation of the monetary policy. In order to maintain the stability of the Rupiah and to promote equitable development, Bank Indonesia is empowered under the Central Bank Act of 1968 to control the money supply and to regulate domestic credit and interest rate, as well as the allocation of credit to the various sectors of economy.

2.2 Regulations

Before the financial reform of June 1983, the major credit policy instruments set by the Central Bank were credit ceilings for individual banks, interest rate controls for state banks, and rediscount credits to priority sectors (called liquidity credit). The priority sectors were eligible for liquidity credits from Central Bank at highly subsidized rates and at varying rediscount proportion, depending upon the type of loan.

The financial reform of June 1983 initiated the Indonesian authority to shift the system of monetary control from direct restrictions on the development of broad money to an indirect system based on reserve money management. The reform aimed at encouraging banks to maximize the mobilization of funds from the public and reducing their dependence on the liquidity credit from the central bank. Through this financial reform, interest rate controls on state banks were eliminated; the liquidity credit mechanism was simplified by phasing out a wide range of loan categories from access to liquidity credits. Only credits with high priority could enjoy such facility (Table 6.13). Credit ceilings on individual banks were also abolished.[2]

In addition to the financial reform undertaken in June 1983, a wide ranging series of deregulatory measures in the financial sector was put into effect in October 1988, March 1989 and January 1990. The new measures were designed to increase more competition and efficiency

2/ Bank Indonesia Circular Letter No. 16/1/UPPK, June 1, 1983.

Table 6.13

PRIORITY CREDIT SCHEMES EXTENDED SINCE 1990

	Bank Credit Int 1/	Bank Credit SF 2/	Liquidity Credit Amount	Liquidity Credit Int	Borrower	Financial Institutions	Term 3/ (years)
I. WORKING CAPITAL CREDIT							
1. Credit for farmers within the framework of intensified cultivation of rice/food crops channeled through village unit cooperatives (KUT)	9%/16% 4/	0%	100%	3%	Rice and food crops - farmers	BRI	1 yr/ 7 mo 5/
II. CREDIT TO COOPERATIVES							
1. Credit to village unit cooperative for the procurement of rice, foodcrops, clove & fertilizer	16%	0%	75%	12%	village unit cooperatives	BRI state & private banks	1
2. Credit to primary cooperatives for their members to finance business outside trade & services sector	13%/16% 6/	0%	75%	8%	members of primary cooperatives	BRI state & private banks	1
III. CREDITS TO BULOG							
1. Credit for rice/food procurement	16% 7/	0%	100%	14% 8/	BULOG	BRI	1
2. Credit for sugar & wheat procurement	16% 7/	0%	100%	14% 8/	BULOG	BRI BBD	1
IV. INVESTMENT CREDIT							
1. Credits channeled through development banks and non bank financial institutions, in	market interest 7/	2a/			all sector projects	BAPINDO B.P.D. UPPINDO PDFCI	min 5
Eastern Indonesia			50% 9/	14% 8/			
Western Indonesia			40% 9/	14% 8/			
2. Credits for commercial banks	market interest 7/	2a/			plantation projects	state & private banks	depend on the period needed
Eastern Indonesia			50% 9/	14% 8/	PIR/PRPTE		
Western Indonesia			40% 9/	14% 8/	PSN PIRTRANS		
3. Smallscale business credits (KUK)	market interest 7/	2a/			all sector businesses & house ownership	state&private banks B.P.R.	as needed

1/ Interest to borrower per annum.

2/ Minimum percentage of self financing of borrower against the total cost needed.

2a/ Minimum percentage of self financing of borrower against the investment need is stipulated by banks.

3/ Maximum maturity.

4/ Interest to village unit cooperative (KUD): 9% p.a.,
interest to farmers: 16% p.a. includes a fee of 7% p.a. for the K.U.D.

5/ The terms of credit to KUD max. 1 yr (12 mo), while
the terms of credit to farmers is 2 week after harvest or a max of 7 mo.

6/ Interest to primary cooperatives: 13% p.a.,
interest to cooperative members: 16% p.a.

7/ The credit interest is connected with the current market rate, stipulated by banks.

8/ The liquidity credit interest is linked with the current money market securities (SBPU) rate.

9/ The share of liquidity credit is to be gradually reduced following this schedule:

Fiscal year	liquidity credit share		fiscal year	liquidity credit share	
	eastern	western		eastern	western
1990/91	50%	40%	1993/94	20%	10%
1991/92	40%	30%	1994/95	10%	0%
1992/93	30%	20%	1995 on	0%	

in the banking and other financial sectors, to promote capital markets, to facilitate effectiveness of monetary management and to reform the liquidity credit scheme. One critical issue not addressed in the 1988 and 1989 reforms was the role and extent of remaining liquidity credits within the banking system. On January 1990, a significant reform of the credit system was announced. The improvement of the credit system was aimed at gradually phasing out the share of Bank Indonesia liquidity credit while maintaining the role of banks in encouraging self-sufficiency in food, promoting cooperatives and investment, and simplifying the interest rate structure so that interest rate become more market related. Moreover, the policy package was aimed at ensuring the availability of credit for small scale business and cooperatives.

Through this policy, subsidized credit schemes (long-term and short-term) were reduced from twenty-three to only four. These four credit schemes consist of credit to farmers (Kredit Usaha Tani or KUT) for working capital, to cooperatives for financing food purchases or productive activities, to BULOG for financing foodstock and sugar procurement, and investment credit (Table 6.13). The rates charged to the end borrowers are to be based on prevailing market rates.[3]

To encourage self-sufficiency in food and simultaneously promote farmers' incomes, credits under KUT scheme which were previously available to finance the rice/foodcrops intensification and the smallholder sugarcane intensification schemes (Tebu Rakyat Intesifikasi or TRI), since January 1990 were only made available to finance the rice/foodcrops intensification program with fully supported funds from Bank Indonesia. In addition, credits under the KUT scheme, which used to be extended only by Bank Rakyat Indonesia (BRI), can now be extended by other banks with the consent of Bank Indonesia. It is noteworthy that the amount of credit under the KUT scheme is now based on the real needs of farmers whereas, according to the previous regulation, it was based on a fixed amount per hectare.[4]

In accordance with January 29, 1990 policy package, Bank Indonesia has adjusted the regulations on credits to cooperatives, to village cooperative units (Koperasi Unit Desa or KUD) and to members of primary cooperatives. These credits are extended by handling banks

3/ Bank Indonesia Circular Letter No. 22/1/UKK, January 29, 1990.

4/ Bank Indonesia Circular Letter No. 22/2/UKK, January 29, 1990.

with a 75 per cent share from Bank Indonesia. Credits to KUD are to be extended not only to finance the procurement of rice and foodcrops but also to finance cloves and fertilizer whose floor prices are determined by the Government. In addition, credit to primary cooperative can be utilized to finance business other than trade and services of the cooperative members, which do not have access to KUT. This credit is also aimed at financing the TRI which used to be financed by KUT. Credit ceilings to primary cooperative members are determined by the need and the capacity of the members to pay back their credits which is related to their savings, with a maximum amount of Rp 30 million. The interest rates to cooperative members are based on the prevailing market rates.[5]

Considering the important of foodstocks and sugar procurement by Bulog, credits for these activities continue to be fully financed by Bank Indonesia. The discount rate charged by Bank Indonesia is based on money market securities (SBPU) rates, whereas the rate charged to Bulog is based on the prevailing market rate.[6]

In view of limited sources of long-term funds, KL Bank Indonesia continued to accomodate part of the need for investment credits. This regulation became effective in February 1990 and such credits are to be chanelled through development banks and development type of NBFIs to support the investment activities in all sector. KL Bank Indonesia are also to be extended to finance plantation estates through commercial and development banks. In the meantime, KL Bank Indonesia extended to finance house ownership which are channeled through banks/NBFIs assigned by Bank Indonesia with a maximum credit of Rp 50 million per customer. In order to foster investment activities in the eastern part of Indonesia, KL Bank Indonesia will be provided on concessional terms.

The maturity for investment credits in the eastern part of Indonesia will be adjusted according to the borrower's needs, while those for western part of Indonesia will only be available for projects which requires credit with a minimum maturity of five years. Maturity for credits extended to the plantation sub-sector is not restricted, either for eastern or western part of Indonesia. The share of Bank Indonesia financing for the projects in the eastern part of Indonesia in 1990/1991

5/ Bank Indonesia Circular Letter No. 22/3/UKK, January 29, 1990.

6/ Bank Indonesia Circular Letter No. 22/7/UKK, January 29, 1990.

is 50 per cent of the total credit, whereas the share of financing for the western part of Indonesia would be only 40 per cent. The rates on investment credits are to be determined by banks and NBFIs while the rates charged by Bank Indonesia are related to the SBPUs' rates.[7] Schemes other than the above four credits schemes are classified as general credits and would be financed by the banks' own resources.

To foster the development of small-scale business, starting February 1990, banks were required to extend 20 per cent of their total credits to small-scale business. This 20 per cent share covers credits financed by banks' own funds, excluding the KL Bank Indonesia. This minimum requirement should be completed by individual banks, including rural credit banks (BPR), within one year after February 1990.[8]

This type of credit known as Kredit Usaha Kecil or KUK. Foreign banks and joint venture banks, which have been required to extend 50 per cent of their total credits to the export sector, are exempted from this requirement.

To broaden the channelling of KUK, banks are encouraged to cooperate, either among commercial banks or between commercial banks and BPRs. To implement effectively the target of extending this scheme to small-scale business, performance under this scheme will be taken into account in rating the soundness of respective banks.

2.3 Supervision Problems

Bank Indonesia as the monetary authority carries out loan supervision intensively based on two banking acts, The Banking Principles Act No. 14, 1967, and Central Bank Act No. 13, 1968. As shown in Chart 1, Bank Indonesia supervises banking institutions and the Ministry of Finance supervises the other financial institutions.

Bank loan (priority credits) supervision is conducted in two ways, namely direct supervision by carrying out on-the-spot examination/field inspections and indirect supervision by examining periodic reports submitted to Bank Indonesia. Field inspection on priority credits is

7/ Bank Indonesia Circular Letter No. 22/6/UKU, January 29, 1990.

8/ Bank Indonesia Circular Letter No. 22/4/UKK, January 29, 1990.

executed independently and regularly by the Credit Departments or as an integrated activity with general supervision/examination of the overall business of banks.

The objectives of the credit supervision are to find out and evaluate the consistency of bank credit policy, the system and procedure of loan, the adequacy of bank's organization and personnel, the bank's compliance, the credit performance, and the overall quality of earnings asset in order to appraise the overall bank loan conditions. This appraisal is an important factor in the consideration of grading the soundness of a bank.

Bank Indonesia exercises the supervisory powers by using the bank rating system. This system is basically designated as one of the important tools in supervising bank. Bank Indonesia also uses this bank rating system in relation to bank supervision policy.

Accordingly bank which is rated as "sound" (a good performance) will be entitled to receive certain facilities and privileges from Bank Indonesia and the Government, such as Bank Indonesia's consideration in expanding the bank operations to become a foreign exchange bank and opening new branch offices, and so on. On the contrary, a bank which has a poor performance may not receive such facilities and privileges.

As mentioned above, the supervision by Bank Indonesia on long-term/investment credit containing an element of Bank Indonesia financing (liquidity credit) has been conducted both directly and indirectly by the Credit Departments.

- Direct supervision is conducted through on the spot examination/field inspection of the project

- Indirect supervision is conducted through examining reports on bad debt and outstanding credit

In field inspection, the supervision is mainly focused on examining the utilization of credit already drawn and realization of the project physical construction against loan withdrawal schedule and project appraisal previously submitted.

Bank Indonesia is involved in analizing feasibility study of a project financed by a long- term loan containing liquidity credit, recommending loans and conducting field inspections as described above, while for non-priority credits, the financial institutions are free to determine the term and condition of credits. The assessment by the Central Bank is based on several aspects, including legal, management, technical, financial, prospect and value added of project in question.

2.4 Implications for the Central Bank

The philosophy of bank loan supervision lies in the reasoning that the supervision is needed in order to reduce risk of bank failure and to ensure that banks could continue to operate efficiently. As mentioned before, Bank Indonesia is involved in analizing feasibility study of a project obtaining long-term loan containing liquidity credit, recommending and supervising loans by conducting field inspections and examining reports on bad debt and outstanding credits. It is considered that the supervision on long-term loan is needed to examine the proper utilization of the credit already drawn and the physical realization of the project. As a matter of fact, the involvement of Central Bank creates bureaucratic requirements that will cause longer processing procedure, but it is considered necessary to prevent loan deliquency and loan default of the liquidity credit as well as the investment credit.

From this point of view, the actual participant in the provision of bank financing is necessary although too stringent regulation and supervision may cause inefficiency in the banking industry. Necessarily, loan supervisory should be adopted flexibly enough to allow adjustment such as the internationalization of bank operations.

III. Issues and Suggestions in Long-Term Financing for Manufacturing and Agricultural Sectors

3.1 Factors Limiting Access to Institutional Credit

Before the reform of January 1990, factors limiting access to long-term financing for the two sectors are mainly because most long-term lending came through the SCBs or NBFIs, via selective credit policy instrument containing liquidity credit from the Central Bank.

Private Commercial Banks (PCB) received very little liquidity credit to fund the long-term lending; instead they have mainly relied on their own savings and time deposits.

Since the eligibility and the amount of funding are determined with the subsidized lending rates to borrowers, the system of liquidity credits is complex; costly to administer, leads to missallocation of resources, and limiting the exercise of credit evaluation capability. Furthermore, SCBs and NBFIs rely heavily on liquidity credit as their resource of fund for long-term financing and long-term deposits (public funds) have not been able to make up the demand for long-term financing.

After the reform of the liquidity credit scheme on January 1990, the liquidity credit mechanism was simplified, but there was still much demand for long-term financing through banks, so they will need additional sources of long-term funds. The major problem is that there is currently no domestic source of long-term funding available, most resources of financing being fairly short-term in nature. The implication was that less long-term credit will go to small or medium sized companies which will have to make do with rollovers; use short-term deposits to fund long-term loans; offshore funds; bond issues or no funds for investment.

3.2 Repayment Problems

Loan deliquency and loan default are common to large and small farmers alike. The agricultural sector would appear to be more prone to delinquency stemming from the first two causes mentioned below.

There are three general reasons for loan overdue, namely:

1. The farmer's/firm's failure to use the borrowed fund appropriately.

2. Adverse environment beyond the borrower's control, such as harvest failure, natural disaster, economic recession, drop in prices of primary products.

3. Farmer's/company's lack of enthusiasm toward repayment and unwillingness of the government to impose sanctions on those whose debts are overdue.

Repayment problems are mainly due to the bad planning and inefficiency of loan management such as a delay in projects construction.

General investment credit financed by liquidity credit is subject to a repayment procedure whereby the borrower is required to submit a repayment schedule in accordance with maturity. The repayment schedule reflects the firm's projected cash flow which is to be submitted upon the application of investment credit.

The above procedure is intended to prevent from loan delinquency and loan default of liquidity credit as well as the investment credit. In case of overdue payment, the loan may be considered for rescheduling on the basis of a revised projected cash flow, after considering the causes of delayed payment.

3.3 Future Needs of Long-Term Financing for Manufacturing and Agricultural Sectors

Recently large investment in the two sectors took place in the west region of Indonesia (mainly Java, Sumatera and Kalimantan) which are already developed and have a good infrastructure. Meanwhile the potential of Indonesia's eastern region have not been fully developed. To promote economic activities and to support equitable development in this region in the future, private sector capacity has to be expanded in the agricultural and manufacturing sectors and to provide public sector investment in infrastructure (such as power, roads, and communications) which will need a substantial amount of long-term funding.

The future needs of long-term financing for agriculture will increase because of efforts on increasing the output of agricultural commodities both through the expansion of cultivated acreage and the replanting of existing acreage, including attempts to attract private investment to develop its own plantations or to develop plantations via the nucleus smallholder estate programme. In addition, efforts to upgrade and standardize the quality of output as well as maintaining its international competitiveness will also boost the future needs for long-term financing.

The future needs of long-term financing for manufacturing will also increase as the government has sought to boost the efficiency and international competitiveness of Indonesia's manufacturing output. The rapid expansion of domestic demand and the effort to compensate import substituting industries by export oriented industries, will also boost the future needs for long-term financing in manufacturing.

3.4 Recommendations for Further Improvements

Considering the factors limiting access to long-term financing on the one hand and the future needs of long-term financing for agricultural and manufacturing sectors on the other hand, it is necessary to make available a variety of instruments through domestic financial markets which will suit the needs of long-term financing for both sectors and increase the allocative efficiency of lending.

Since infrastructure is a basic need to support equitable development in the eastern region of Indonesia, the government should continue to provide long-term loan especially for providing infrastructure such as electricity, roads and communication. The borrowing at the same time can also be used to fill the gap left by withdrawal of liquidity credits. In the meantime, this effort is expected to attract private investment, either foreign or domestic, in the region.

Furthermore government could enact rules requiring a certain percentage of insurance and pension funds to be invested in either agricultural or manufacturing sectors. Security of the lenders should be improved and the bankruptcy laws should be better enforced to allow financial institutions for building sources of funds.

To make available a variety of financial instruments and financial market to suit the needs of long-term financing, the government should have a clear objective of instruments and market they would like to have in place.

The SBI and SBPU should be developed and traded in enough quantity for being used as reference rates for financial institutions in basing their lending rates and as a source of long-term financing. The government should play an active role to encourage funds such as pension funds, insurance company funds and state enterprise fund to move into the bond market.

To increase the allocative efficiency of lending, market rates based on a recognized single prime rate should be used for both funding sources and lending and the loans allocation should be based on profit motive.

IV. Major Findings and Concluding Remarks

Long-term financing is needed to develop manufacturing and agricultural sectors. In Indonesia, banking institutions and non-bank financial institutions (before 1992) are the principal institutions in financing both the sectors. The State Commercial Banks and the former Development Finance Institutions which specialized their services in the specific sectors of the economy are the major sources of long-term financing for both sectors. Since the financial reform of June 1983 which was aimed at encouraging banks to maximize the mobilization of funds from the public and reducing banks dependence on the rediscount credit facility or liquidity credit from the Central Bank, the State Commercial Banks are allowed to manage their portfolio outside their specific sector of economy as designated.

Observing the development of long-term financing for both sectors during 1979-1989 we find that the average growth rates of long-term financing for agricultural (38.9 per cent) and manufacturing (25.9 per cent) sectors, were higher than that of total financing for both sectors.

The share of agricultural sector in aggregate financing at the end of 1989 was 8.3 per cent, much less than its 22.5 per cent share in long-term financing. The manufacturing sector's share in aggregate financing at the end of 1989 was 32.0 per cent which was lower than its 43.1 per cent share in long-term financing. For all sectors, the ratio of long-term financing averaged between 23.4 per cent to 45 per cent during 1979-1989. At the end of 1989, the long-term financing for agricultural sector accounted for around 64 per cent of total financing whereas for the manufacturing sector it accounted for about 32 per cent of total financing.

Examining the ratio and sources of long-term financing for both sectors according to the original specialization of the 3 state commercial banks (SCBs) and 1 development finance company (NBFI) as at end of 1980, 1985 and 1989, it is noted that until 1985 their loan portfolios reflected their specialization and their sources of funds relied heavily on liquidity credit from Bank Indonesia. But after the financial reform of 1983 and 1988 their loan portfolios began to reflect the diversification and the sources of funds were replaced by public funds.

The share of agricultural and manufacturing sectors to total long-term financing by BRI and Bank Exim as the SCBs emphasizes in financing the agricultural sector and the export-import of commodities which had been shifting. As at end of 1980 and 1985 the shares of agricultural sector in aggregate long-term financing by BRI was larger than that of manufacturing, but it decreased at the end of 1989, whereas that of the manufacturing sector increased. The share of agricultural sector in total long-term financing by Bank Exim has increased by the end of 1989, whereas the share of manufacturing sector has decreased.

The principal sources of funds of BRI, Bank Exim and Bapindo consist of deposits and borrowings from Bank Indonesia. The share of deposits shows an upward trend, whereas borrowings from Bank Indonesia has decreased.

During 1983-1990 the major instrument of long-term/credit policy was rediscount credits to priority sectors (called as liquidity credits). Banks, especially SCBs, were encouraged to provide priority loans which were eligible for liquidity credit from Bank Indonesia at varying rediscount proportion. The policies and procedures on the application for these type of loans are set by the financing institutions on the basis of guidelines issued by Bank Indonesia in its circular letters.

Since the financial reform of January 1990, the number of sectors eligible for liquidity credit were reduced and the interest rates have moved much closer to the market rates.

The subsidized credit schemes now consist of only credit to farmers for working capital, to cooperatives for financing food purchases or productive activities, to BULOG for financing foodstock and sugar procurement, and investment credit.

The liquidity credit mechanism was simplified, however there will still be much demand for long-term financing through banks, so additional sources of long-term funds are needed. The major problem is that currently most sources of financing are being fairly short-term in nature.

Bank Indonesia as the central bank supervises and controls the provision of long-term financing by on-the-spot examination/field inspection and indirect supervision. Bank Indonesia is also involved in analizing feasibility study of a project financed by long-term loan containing liquidity credit. The involvement of Central Bank in recommending loan and conducting supervision is considered necessary to prevent loan deliquency and loan default.

To promote economic activities and to support equitable development in the eastern region of Indonesia in the future, a substantial amount of long-term financing in agricultural and manufacturing sector is needed.

Efforts on increasing the output of agricultural commodities including attempts to attract private investment and maintaining the efficiency and international competitiveness of Indonesia's manufacturing output will also boost the future needs for long-term financing.

To meet the needs for long-term financing as mentioned above, banks need an environment whereby they can transform the public funds to suit the needs of long-term financing and a recognized single prime rate in the financial system. It is necessary to make available a variety of instruments through the domestic financial market, but the government should have a clear objective of the instrument and market they would like to see in place. The government should also play an active role to encourage funds such as pension funds, insurance company funds and state enterprise fund to move into the financial market.

Main Export and Import Commodities

	Main Export Commodities		Main Import Commodities
1986	Plywood, Coffee, Rubber, Garments, Sawn timber, Textile, Lobster, Shrimps and prawn, Aluminium, Copper, Pepper, Tin, Fertilizer, Nickel, Palm oil and kernel, and Tea.	1986	Machinery, Chemical products, Base Metal, Article plastics materials, Vehicles, Cereals, Vessel, Motor thereof, parts for motorcars, Paper, Pharmaceutical products, Semi manufactured metal, Motor cycle and parts, Raw cotton, Aircrafts, Motor thereof, and motor for motorcars.
1987	Plywood, Rubber, Garments, Sawn timber, Coffee, Textile, Lobster, Shrimps and prawn, Aluminium, Iron Steel, Copper, Pepper, Rattan and Rattan products, Tin, Nickel, and Tea.	1987	Machinery, Chemical products, Base metal, Article plastic material, Motorcycles and parts, Vessel, motor thereof, parts of motorcars, Cereals, Paper, Raw cotton, Paper Pharma ceutical products, Vehicles, Semi manufactured metal, tractors and trucks, Aircrafts, and motor thereof.
1988	Plywood, Rubber, Garments, Sawn timber, Textile, Coffee, Lobster, Shrimps and prawn, Iron Steel, Gold bullion, Nickel, Palm oil and kernel, Aluminium, Copper, Foodstuffs, and Tin.	1988	Machinery, Chemical products, Base metal, Article plastics material, Parts of motorcar, Paper, Semi manufactured metals, Cereal, Raw cotton, Vessels, motor thereof, Pharmaceutical products, Vehicles, Motorcycles and parts, Motors for for motorcars, and Weaving yarn artificle fibre.
1989	Plywood, Garments, Rubber, Textile, Sawn timber, Lobster, Shrimps and prawn, Coffee, Nickel, Iron Steel, Aluminium, Copper, Palm oil and kernel, Tin, Gold bullion, and Foodstuffs.	1989	Machinery, Chemical products, Base metal, Article plastics material, Parts of motorcar, Cereals, Paper, Semi manufactured metals, Vessel, motor thereof, Raw cotton, Pharmaceutical products, Weaving yarn artificle fibre, Motor for motorcars, Vehicles, and Motorcycle and parts.

GLOSSARY

Badan Koordinasi Penanaman Modal (BKPM) or Investment Coordinating Board is an official government agency incharged of supervising private investments, both domestic and foreign.

Badan Urusan Logistik (BULOG) or Board of Logistic Affairs is a government agency responsible for ensuring an adequate availability of several essential foods, and rice in particular.

Bank Pembangunan Daerah (BPD) or regional (state owned) development bank is a development bank owned by the regional (province) authorities, extending medium and long-term loans for development projects.

Bank Perkreditan Rakyat (BPR) or rural credit bank is a rural bank, such as market bank, employee bank, village bank, and paddy bank. The type of bank is engaged primarily in accepting savings and extending loans to traders in market places or villages. The operation of this type of bank is limited to regencies/villages.

Bank Tabungan Negara (BTN) is a state owned savings bank. Before the financial reform of October 1988, its functions is collecting deposits in the forms of savings such as National Development Savings Scheme (Tabungan Pembangunan Nasional or Tabanas), Time Insurance Savings Scheme (Tabungan Asuransi berjangka or Taska), savings for the downpayment in house ownership credit scheme and other small savings. Its extend loans mainly for the house ownership credit scheme (KPR).

Bimbingan Massal (BIMAS) or massguidance is a government programme for the provision of subsidized credit and modern yield increasing input to rice cultivators aimed at promoting self-sufficiency in rice.

Eastern region of Indonesia. Geographically Indonesia is divided into three regions, Western, Central and Eastern. However, in regard to regional division of economic development, Indonesia is usually devided into two regions, namely, western and eastern. As stipulated by the Bank Indonesia circular letter No. 22/6/UKU January 29, 1990, east Indonesia region comprising provinces of Irian Jaya, Maluku, East Timor, East Nusa Tenggara, West Nusa Tenggara, Central Sulawesi, South East Sulawesi and Central Kalimantan. Western region of Indonesia comprising provinces in the islands of Sumatera (8 provinces), Jaya (5 province), and provinces of Bali, West Kalimantan, South Kalimantan, East Kalimantan, North Sulawesi and South Sulawesi.

Economically-weak Group is a group comprising either small-scale entrepreneurs, including farmers, fishermen, and craftsmen or small-scale corporate bodies. This group is eligible to obtain KIK and/or KMKP credits.

Koperasi Unit Desa (KUD) or village unit cooperative is a primary cooperative established by farmers. This cooperative is primarily entrusted with distributing farm inputs, channeling credits to farmers, and marketing farm products.

Kredit Investasi Kecil (KIK) or small-scale investment credit, is a credit (medium-or long-term) especially designed to assist indigenous small-scale entrepreneurs or enterprises for financing their working capital needs.

Kredit Pemilikan Rumah (KPR) or house ownership credit, is a soft-term credit for financing low cost housing. This credit is available for an employee (government or non-government) with an income not exceeding that of a government employee of category IV and is extended through State Saving Bank (BTN).

Kredit Usaha Kecil (KUK) or credit to small-scale businesses is a credit provided to businesses with a maximum total assets of Rp. 600 million (not including the value of land and estates) and used for the financing of productive business including the financing of the ownership of houses of type 70 or smaller. The maximum amount of this credit to each customer is Rp. 200 million.

Kredit Umum Pedesaan (Kupedes) or general rural credit is a credit designed to encourage the development of small-scale entrepreneurs in rural areas.

Kredit Usaha Tani (KUT) or Kredit to farmers is a credit which were previously available to finance rice/foodcrops intensification and the smallholder sugarcane intensification scheme since January 1990 were only made available to finance rice/foodcrops intensification program with fully supported funds from Bank Indonesia.

Negative list of investment is a list issued annually by the BKPM indicating the list of business sectors that are closed for foreign and domestic private investment.

PT Asuransi Kredit Indonesia (PT Askrindo) is a private indemnity insurance company, functions primarily to provide insurance for small-scale investment credits (KIK), permanent working capital credits (KMKP) and working capital credit up to Rp. 75 million.

Perkebunan Besar Swasta Nasional (PBSN/PSN) or private national estate is a scheme for developing agricultural estates by assisting private sector on special terms and conditions in financing their agricultural projects.

Perusahaan Umum Pengembangan Keuangan Koperasi (Perum PKK) is a state corporation with the main task of covering risks on credits extended by banks to cooperatives.

Perusahaan Inti Rakyat (PIR) or smallholders' nuclues estate, is a scheme for developing small holders business by assigning more established agricultural estates as a nucleus to provide guidance in cultivating, managing, processing and marketing products.

This scheme is carried out, among others, in plantations (PIRBUN), poultry farms (PIR-Unggas) and fisheries (Tambak Inti Rakyat/TIR).

Perusahaan Inti Rakyat Transmigrasi (PIRTRANS). The same scheme as the PIR above. The difference lies only on the fact that "PIRTRANS" members are all transmigrants.

Peremajaan, Rehabilitasi and Perluasan Tanaman Ekspor (PRPTE) or replanting, rehabilitation and expansion of export commodity crops is a scheme designed to assits small holders for replanting, rehabilitating and expansion of their export commodity crops.

Sertifikat Bank Indonesia (SBI) or Bank Indonesia Certificate, is a certificate of deposits issued by Bank Indonesia that may be sold to banks or NBFIs and may be trade among them or be discounted to the securities house. The securities house may, in turn, rediscount them to Bank Indonesia.

Surat Berharga Pasar Uang (SBPU) or money market securities, is a short-term securities issued by a businees entity or a bank, which may be traded among banks or NBFIs. In addition, banks and NBFIs may discount the SBPUs to the securities house and the securities house may, in turn, rediscount them to Bank Indonesia. The securities house is an NBFI designated to execute the trading of its own or its customers' SBPUs.

Chapter 7

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN KOREA

by

Nae-Hwang Lee

I. An Overview of the Existing Conditions of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Nature of Long-Term Financing for Manufacturing and Agricultural Sectors[1]

1.1.1 Overview

In Korea, all banking institutions take part in long-term financing for the manufacturing and agricultural sectors. Commercial banks, which comprise nationwide commercial banks, local banks, and foreign bank branches, mainly engage in commercial banking business. But they also conduct long-term financing business. Specialized banks which are established for supplying loans to specific sectors also engage in long-term financing business. Specialized banks include the Industrial Bank of Korea, the Citizens National Bank, the Korea Housing Bank, the credit and banking sector of the National Agricultural Cooperative Federation, the credit and banking sector of the National Federation of Fisheries Cooperatives and Member Cooperatives, and the credit and banking sector of the National Livestock Cooperatives Federation. Development institutions, which are established for the long-term financing for specific sectors and the development of major industries, supply most of their funds in the form of long-term financing for periods over one year. Among them, the Korea Development Bank and the Export-Import Bank of Korea are established by the government, and the Korea Long Term Credit Bank is privately established.

Besides banking institutions, merchant banking corporations, trust accounts of banks, and life insurance companies also engage in

1/ Long-term loans in this paper are defined as loans with maturities of over one year.

Table 7.1

FINANCIAL INSTITUTIONS IN KOREA
(As at the end of 1990)

- Central Bank
  - The Bank of Korea
- Banking Institutions (Deposit Money Banks)
  - Commercial Banks
    - Nationwide Commercial Banks (11)
    - Local Banks (10)
    - Foreign Bank Branches (69)
  - Specialized Banks
    - The Industrial Bank of Korea
    - The Citizens National Bank
    - The Korea Housing Bank
    - The Credit and Banking Sector of National Agricultural Cooperative Federation
    - The Credit and Banking Sector of National Federation of Fisheries Cooperatives
    - The Credit and Banking Sector of National Livestock Cooperatives Federation
- Non-Bank Financial Institutions
  - Development Institutions
    - The Korea Development Bank
    - The Export-Import Bank of Korea
    - The Korea Long Term Credit Bank
  - Savings Institutions
    - Trust Accounts of Banking Institutions (53)
    - Mutual Savings and Finance Companies (237)
    - Credit Unions (1,315)
    - Mutual Credit (1,838)
    - New Community Finance Associations (3,245)
    - Postal Savings (Post Offices)
  - Investment Companies
    - Investment and Finance Companies (32)
    - Merchant Banking Corporations (6)
  - Life Insurance Companies
    - Life Insurance Companies (26)
    - Foreign Life Insurance Company Branches (4)
    - Postal Life Insurance (Post Offices)
  - Other Institutions
    - The National Investment Fund
    - The National Housing Fund
    - Leasing Companies (20)
    - Venture Capital Companies (52)
    - Non-Life Insurance Companies (16)
    - Credit Guarantee Funds (3)
    - The Korea Non-Bank Deposit Insurance Corporation
- Securities Market
  - The Securities Supervisory Board
    - Securities Companies (25)
    - The Korea Securities Finance Corporation
    - Securities Investment Trust Companies (8)
  - The Korea Stock Exchange

Note: Figures in parentheses represent the number of institutions.

long-term financing business. But their market share has been traditionally small compared with that of banking institutions.

In observing long-term financing for both agricultural and manufacturing sectors during 1980-1990, we found that the growth of long-term financing for both sectors outpaced that of short-term financing. And the growth rate of long-term financing for all sectors (21.0 per cent) was lower than that of total financing for all sectors (22.0 per cent). But the average growth rates, 24.2 per cent and 22.0 per cent respectively, of long-term financing for agricultural and manufacturing sectors were slightly higher than that of total financing for both sectors, 23.9 per cent and 19.2 per cent respectively. The ratio of long-term financing for agricultural sector to aggregate long-term financing increased from 10.6 per cent as at the end of 1980 to 13.6 per cent as at the end of 1990. That of the manufacturing sector had decreased in the early 1980s but increased again from 1985 to stand at 41.1 per cent as at the end of 1990.

The share of the agricultural sector in aggregate financing as at the end of 1990 was 5.1 per cent much less than its 13.6 per cent share of long-term financing. But the manufacturing sector's share in aggregate financing was 44.0 per cent which was broadly similar to its 41.1 per cent share of long-term financing. For all sectors, the ratio of long-term financing to total financing averaged between 22-25 per cent during 1980-1990. But in the agricultural sector, long-term financing accounted for around 60 per cent of total financing whereas the share was only about 20 per cent in the case of the manufacturing sector.

To analyze the significance of long-term financing for the two sectors in Korea, we tabulated its proportionate share to GDP, total exports, and value added in the two sectors. From this table, it may be observed that the ratio of long-term financing for the two sectors to GDP, total exports, and value added in the two sectors all increased steadily during 1980-1990.

1.1.2 Long-Term Financing for the Manufacturing and Agricultural Sectors by Product/Use

In a breakdown of long-term financing to the manufacturing sector by product, it is clear that the predominant share was provided to the fabricated metal products, machinery and equipment sub-sector, whose share was 34.7 per cent as at the end of 1990. In addition, chemicals, petroleum, coal, rubber and plastic products (24.2 per cent), primary metal (11.5 per cent), textiles, wearing apparel and leather (10.4 per cent) also accounted for a high proportion of lending. But the shares of non-metallic mineral products (6.7 per cent), food beverages and tobacco (5.6 per cent) and wood and wood products including furniture (0.7 per cent) were relatively low. Classifying these sub-sectors as being either export-oriented or import substitution

Table 7.2

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS 1/
(Outstanding balance)

(Unit in Billion Won, %)

Year-end	Long-term financing 2/			Total financing 3/			A/D	B/E	C/F
	Agricultural sector(A)	Manufacturing sector(B)	All sectors(C)	Agricultural sector(D)	Manufacturing sector(E)	All sectors(F)			
1980	439.5	1,626.4	4,157.7	759.4	9,624.2	17,264.7	57.9	16.9	24.1
	(10.6)	(39.1)		(4.4)	(55.7)				
1981	593.9	2,089.2	5,306.2	976.5	12,593.8	22,765.7	60.7	16.6	23.3
	(11.2)	(39.4)		(4.3)	(55.3)				
1982	748.2	2,586.2	6,954.1	1,129.1	14,405.7	28,637.7	66.3	17.9	24.3
	(10.8)	(37.2)		(3.9)	(50.3)				
1983	1,049.7	2,918.5	8,734.1	1,537.1	16,211.4	34,540.8	68.3	18.0	25.3
	(12.0)	(33.4)		(4.5)	(46.9)				
1984	1,347.2	3,180.9	10,015.4	1,992.6	19,527.7	42,307.5	67.6	16.3	23.7
	(13.5)	(31.8)		(4.7)	(46.2)				
1985	1,608.2	3,845.2	11,730.9	2,341.4	22,902.2	50,674.1	68.7	16.8	23.1
	(13.7)	(32.8)		(4.6)	(45.2)				
1986	1,833.1	5,960.3	14,394.3	2,705.9	27,355.1	59,553.0	67.7	20.9	24.2
	(12.7)	(39.5)		(4.5)	(45.8)				
1987	2,082.9	7,109.4	16,628.8	3,721.4	31,426.3	68,601.5	56.0	22.6	24.2
	(12.5)	(42.8)		(5.4)	(45.8)				
1988	2,634.5	8,334.9	19,022.1	4,442.1	35,574.7	79,125.3	59.3	23.4	24.0
	(13.8)	(43.8)		(5.6)	(45.0)				
1989	3,110.4	9,547.7	22,240.1	5,217.6	44,399.8	102,628.6	59.6	21.5	21.7
	(13.9)	(42.9)		(5.1)	(43.3)				
1990	3,754.4	11,385.3	27,707.0	6,355.8	55,090.1	125,201.2	59.1	20.7	22.1
	(13.6)	(41.1)		(5.1)	(44.0)				
Average annual rate of increase of 1981-1990	24.2	22.0	21.0	23.9	19.2	22.0			

1/ Figures in parentheses represent the share of that sector in the all-sectors total.

2/ Loans with maturities of over one year. Long-term loans by the Export-Import Bank of Korea, merchant banking corporations, and life insurance companies are not included because of the lack of statistical data

3/ Supplied by commercial banks, specialized banks, development institutions, investment and finance companies, merchant banking corporations, trust accounts of banks, and life insurance companies.

Table 7.3

RATIO OF LONG-TERM FINANCING FOR THE TWO SECTORS TO GDP, TOTAL EXPORTS, AND VALUE ADDED IN THE TWO SECTORS

(Unit in Billion Won, %)

	Aggregate long-term financing for the two sectors (A)	G D P (B)	Total exports (C)	Value added in the two sectors (D)	A/B	A/C	A/D
1980	2,065.9	38,041.1	10,419.7	16,975.9	5.4	19.8	12.2
1981	2,683.1	47,482.0	13,885.4	21,629.2	5.7	19.3	12.4
1982	3,335.5	54,442.8	14,759.2	23,896.8	6.1	22.6	14.0
1983	3,968.2	63,832.8	18,064.6	27,783.7	6.2	22.0	14.3
1984	4,528.1	72,644.3	21,240.8	31,767.4	6.2	21.3	14.3
1985	5,453.4	80,846.9	23,018.1	34,882.2	6.7	23.7	15.6
1986	7,523.4	93,423.8	29,866.3	40,308.0	8.1	25.2	18.7
1987	9,192.3	108,428.3	37,919.4	46,256.6	8.5	24.2	19.9
1988	10,969.4	127,962.7	43,457.5	55,111.2	8.6	25.2	19.9
1989	12,558.1	142,266.8	41,141.6	59,006.2	8.9	30.8	21.5
1990	15,139.7	169,701.4	45,302.4	64,943.6	8.9	34.4	23.3

commodities, we may consider textiles, wearing apparel and leather, basic metal and fabricated metal products, machinery and equipment as being export-oriented. But in view of the pattern of Korean export-import trade during 1980s, both the basic metal and the fabricated metal products, machinery and equipment sectors may be classified as both export-oriented and import substitution commodities.

When we observe the trends of the shares of products in aggregate long-term financing for manufacturing during 1980-1990, the shares allocated to the textiles, wearing apparel and leather sector and the non-metallic mineral products sector decreased but the share of the chemical, petroleum, coal, rubber and plastic products sector was on an increasing trend.

Because a precise classification of long-term financing for the agricultural sector according to use is impossible owing to the lack of

Table 7.4

LONG-TERM FINANCING FOR THE MANUFACTURING SECTOR BY PRODUCT
(Year-end Figures)

(Unit in Billion Won, %)

	Food, beverages & tobacco	Textiles, wearing apparel & leather	Wood & Wood products including furniture	Paper & paper products, printing & publishing	Chemicals, petroleum, coal, rubber & plastic products	Non-metallic mineral products	Basic metal	Fabricated metal products, machinery & equipment	Others	Total
1980	3.2	13.4	0.9	4.2	15.6	9.5	19.9	31.0	2.3	100.0
1981	3.4	14.0	1.6	3.6	15.8	12.1	17.9	29.0	2.6	100.0
1982	3.7	14.4	1.6	3.1	14.8	10.4	17.0	31.6	3.4	100.0
1983	4.7	13.6	1.2	4.2	14.7	10.0	14.3	34.5	2.8	100.0
1984	5.1	13.1	1.4	5.4	15.0	10.2	12.5	35.0	2.3	100.0
1985	5.7	12.6	1.4	4.9	14.7	9.5	10.8	38.1	2.3	100.0
1986	6.6	12.2	0.7	4.4	13.6	7.4	11.4	42.0	1.7	100.0
1987	5.5	12.2	0.6	3.7	16.7	6.2	11.3	42.1	1.7	100.0
1988	5.5	12.1	0.6	3.9	19.5	5.5	10.8	40.6	1.5	100.0
1989	5.5	11.7	0.6	3.7	21.0	6.1	11.7	38.0	1.7	100.0
1990	5.7	10.4	0.7	3.7	24.2	6.9	11.5	34.7	2.2	100.0

Table 7.5

MAIN EXPORT AND IMPORT COMMODITIES

	Main export commodities	Main import commodities
1983	Apparel & accessories (15.2%) Ships (9.3%), Footwear (5.1%), Ingots & plates of iron or steel (4.3%)	Crude petroleum (21.3%), Organic chemicals (4.0%), Coal, coke & briquets (2.5%), Maize (2.3%)
1985	Apparel & accessories (14.7%) Ships (6.2%), Footwear (5.1%), Woven fabrics, other than cotton (4.4%)	Crude petroleum (17.9%), Organic chemicals (4.3%), Thermionic valves & semiconductors (3.6%), Coal, coke & briquets (3.3%)
1987	Apparel & accessories (24.9%) Footwear (9.1%), Passenger cars (9.1%), Thermionic valves & semiconductors (7.9%)	Crude petroleum (8.3%), Thermionic valves & semiconductors (6.2%), Organic chemicals (5.1%), Ingots & plates of iron or steel (9.1%)
1989	Apparel & accessories (14.6%) Thermionic valves & semiconductors (7.5%), Electronic products (6.9%), Footwear (5.8%)	Crude petroleum (8.0%), Thermionic valves & semiconductors (6.6%), Organic chemicals (5.8%), Ingots & plates of iron or steel (3.6%)

Note: Figures in parentheses represent the share of each commodity in total exports or total imports.

Table 7.6

AGRICULTURAL LONG-TERM FINANCING OF NACF ACCORDING TO USE
(Year-end Figures)

(Unit in Per Cent)

	Agricultural mechanization	Irrigation	Young prospective farmer support	Agricultural development	Rural housing	Integrated development	Others	Total
1980	15.7	12.9	-	13.0	45.9	2.7	9.8	100.0
1981	21.1	12.9	0.9	12.9	43.7	2.9	5.6	100.0
1982	24.8	14.4	2.2	13.6	38.7	2.8	3.5	100.0
1983	27.1	14.7	3.0	14.0	34.9	2.8	3.5	100.0
1984	26.7	14.9	5.0	14.6	32.1	2.8	3.9	100.0
1985	24.6	14.0	8.4	14.7	29.1	2.8	6.4	100.0
1986	23.6	13.5	12.7	15.0	26.1	2.4	6.7	100.0
1987	7.4	13.0	12.0	11.6	23.6	24.9	7.5	100.0
1988	22.3	12.0	10.6	8.1	19.8	19.1	8.1	100.0
1989	26.4	11.4	10.4	6.8	19.2	16.9	8.9	100.0
1990	23.2	8.8	7.9	4.9	15.7	12.7	26.8	100.0

statistical data, we examine the long-term financing of the credit and banking sector of the National Agricultural Cooperative Federation (NACF) only and analyze it according to use. This procedure may be considered to give a reasonable approximation because the credit and banking sector of the NACF supplies most of the long-term financing for the agricultural sector.[2]

From such a breakdown, we find that as at the end of 1990 comparatively large shares of funding went to agricultural mechaniza-

2. As at the end of 1990, the credit and banking sector of the NACF supplied 91.4 per-cent of the aggregate long-term financing for the agricultural sector.

tion (23.2 per cent), rural housing (15.7 per cent), and integrated development (12.7 per cent). When we observe the trends over the eleven years, it is apparent that the shares allocated to irrigation and rural housing were on a decline but those of agricultural mechanization and integrated development were on an upward trend.

1.1.3 Contribution of the Manufacturing and Agricultural Sectors in Promoting Employment and Exports

In order to find the contribution of the two sectors to employment, we calculate each sector's share in total employment and the growth rates of employment in the two sectors. Using this analysis, it is found that the share of agricultural employment in total employment decreased from 19.9 per cent as of December 1980 to 13.0 per cent as of December 1990. The share of manufacturing employment in total employment increased from 25.3 per cent as of December 1980 to 30.4 per cent as of December 1988. But from that year there was a reversal of this upward trend and its share slipped to 28.2 per cent as of December 1990.

When we observe the growth of employment in the two sectors and compare it with the overall growth in employment, there was negative average growth of 0.7 per cent in agriculture during 1980-1990. The average rate of growth of employment in manufacturing during 1980-1990 was 5.3 per cent higher than the all-sector figure of 4.05 per cent. If we break down the average annual growth rate of overall employment (4.05 per cent) during 1980-1990 into agriculture, manufacturing, and other sectors, the contributions to overall employment of the manufacturing and other sectors were 1.37 per cent and 2.7 per cent, respectively, whereas agriculture made a negative contribution of 0.02 per cent.

In Table 7.8, the share of the two sectors' exports in total exports and the sectoral rate of increase of exports are presented. The share of the agricultural sector's exports to total exports marked around 2 per cent during 1980-1990, and that of the manufacturing sector was around 94 per cent during the latter part of the 1980s. The rate of increase in exports averaged 15.4 per cent in the agricultural sector and 14.9 per cent in the manufacturing sector during 1981-1990. Both of these sectoral rates exceeded the average rate of increase for total sectors of 14.55 per cent. If we break down the average annual growth rate of overall exports (14.55 per cent) during 1980-1990 into agriculture, manufacturing, and other sectors, the contribution to overall exports of the manufacturing sector was 13.84 per cent, whereas the contributions of the other sectors and the agricultural sector were 0.49 per cent and 0.22 per cent respectively. Hence, the contribution of manufacturing was virtually absolute in amount but that of agriculture and other sectors was very small.

Table 7.7

CONTRIBUTION OF AGRICULTURAL AND MANUFACTURING SECTORS TO EMPLOYMENT 1/

(Unit in Per Cent)

	Share of total employment		Rate of increase in employment 2/						
	Agricultural sector	Manufacturing sector	Total	Agricultural sector		Manufacturing sector		Other sectors	
1980	19.9	25.3							
1981	20.6	24.0	4.2	8.5	(1.6)	-1.0	(-0.3)	5.2	(2.9)
1982	20.3	24.4	5.7	3.9	(0.8)	7.0	(1.7)	4.2	(3.2)
1983	19.5	24.9	0.7	-3.4	(-0.6)	2.8	(0.7)	2.8	(0.6)
1984	17.8	25.6	3.1	-5.4	(-1.1)	6.1	(1.5)	4.8	(2.7)
1985	16.1	26.1	2.2	-7.8	(-1.4)	4.3	(1.1)	4.4	(2.5)
1986	16.0	27.9	6.3	5.8	(0.9)	13.8	(3.6)	3.0	(1.8)
1987	14.8	28.9	6.0	-2.1	(-0.3)	9.9	(2.7)	6.4	(3.6)
1988	13.1	30.4	2.8	-8.6	(-1.3)	7.9	(2.3)	3.2	(1.8)
1989	14.4	27.8	5.6	7.9	(2.1)	-3.5	(-1.1)	8.0	(4.6)
1990	13.0	28.2	3.9	-6.1	(-0.9)	5.3	(1.5)	5.8	(3.3)
Average during 1981-1990	-	-	4.05	-0.7	(-0.02)	5.3	(1.37)	4.8	(2.7)

1/ Employment is as of December in every year.

2/ Figures in parentheses represent sectoral contributions to the overall rate of increase in employment.

Table 7.8

CONTRIBUTION OF AGRICULTURAL AND MANUFACTURING SECTORS TO EXPORTS 1/

(Unit in Per Cent)

	Share of total employment		Rate of increase in exports 2/						
	Agricultural sector	Manufacturing sector	Total	Agricultural sector		Manufacturing sector		Other sectors	
1980	2.6	92.3							
1981	2.1	92.9	19.9	-6.1	(-0.2)	20.8	(19.2)	17.8	(0.9)
1982	1.8	93.7	3.0	-8.4	(-0.2)	3.8	(3.6)	-8.5	(-0.4)
1983	1.8	94.4	12.1	7.6	(0.1)	12.9	(12.1)	-3.1	(-0.1)
1984	1.7	95.0	20.7	15.1	(0.3)	21.5	(20.3)	4.2	(0.1)
1985	1.4	95.3	3.6	-12.9	(-0.2)	4.0	(3.7)	1.0	(0.1)
1986	1.4	94.6	14.6	17.6	(0.2)	13.6	(11.4)	43.3	(3.0)
1987	1.5	94.8	36.2	38.5	(0.6)	36.5	(34.5)	20.8	(1.1)
1988	2.1	94.4	28.4	89.0	(1.3)	27.9	(26.5)	15.1	(0.6)
1989	2.4	94.5	2.8	15.1	(0.3)	2.9	(2.7)	-8.3	(-0.2)
1990	2.2	94.9	4.2	-1.8	(0.0)	4.7	(4.4)	-4.2	(-0.2)
Average during 1981-1990	-	-	14.55	15.4	(0.22)	14.9	(13.84)	7.6	(0.49)

1/ Total exports are classified into agricultural, fishery, mining and manufacturing products, with agricultural products being regarded as exports of the agricultural sector and manufacturing products as exports of the manufacturing sector.

2/ Figures in parentheses represent sectoral contributions to the overall rate of increase in exports.

1.1.4 *Other Institutions Involved in the Financing and Development of the Two Sectors*

In this part, we discuss the role of other institutions involved in the financing and development of the two sectors. In the agricultural sector, the NACF's economic business sector is regarded as the principal institution involved in the development of the agricultural sector. Leasing companies and venture capital companies are counted as institutions involved in the financing and development of the manufacturing sector.

The NACF and its member cooperatives were formed in 1961 under the Agricultural Cooperatives Act, their objective being the development of agricultural productivity and the raising of the economic and social status of farmers. The NACF also carries out training programs for members of its cooperatives along with management consultancy, the sale, processing and distribution of agricultural products, the purchase of fertilizers, etc.

Leasing companies provide business enterprises, especially small and medium firms, with medium and long-term financing for equipment, machinery and plant, etc. The first leasing company was established in 1973 and a number of leasing companies were set up during 1985-1990. At present, there are twenty leasing companies. Moreover, six merchant banking companies and three venture capital companies also participate in the leasing business. Most leasing contracts are long-term contracts of over three years and the bulk of the companies' activities are concentrated on the manufacturing sector. As at the end of 1989, the outstanding balance of leasing contracts amounted to 11,055 billion won. And the ratio of outstanding balance of leasing contracts to the aggregate long-term financing supplied by financial institutions was 49.7 per cent as of the end of 1989.

There are two types of venture capital companies. The first type consists of new technology enterprise financial support companies and the other of small and medium enterprise start-up support companies. The major business of the former companies lies in providing financial support for technology development projects by underwriting stocks and convertible bonds issued by new or established business firms, extending loans and offering leasing and factoring services. And the latter companies provide financial support through underwriting securities of start-up business and also supply management consultancy. As at end of 1990, there were four new technology enterprise financial support companies and fifty-two small and medium enterprise start-up support companies. As at the end of June 1990, the total outstanding financial support extended by the four new technology enterprise financial support companies stood at 426 billion won and the aggregate investment of the fifty-two small and medium enterprise start-up support companies amounted to 237 billion won. The ratio of total outstanding financial support of venture capital companies to the long-term financing supplied by all financial institutions was 2.7 per cent as at the end of June 1990.

1.2 Sources of Long-Term Financing

Examining the long-term financing institutions by dividing long-term financing outstanding as at the end of 1990 according to institutions and industries, it may be readily noted that the credit and banking sectors of the NACF and the National Livestock Cooperatives Federation (NLCF) are the major long-term financing institutions for agriculture. As at the end of 1990, most long-term financing for agriculture was supplied by the credit and banking sectors of the NACF (91.4 per cent) and the NLCF (8.5 per cent). The ratio of long-term financing for agriculture to total long-term financing by particular institutions as at the end of 1990 was 75.0 per cent for the credit and banking sector of the NACF and 91.3 per cent for the credit and banking sector of the NLCF.

Table 7.9

AMOUNT OF LEASING CONTRACTS
(Annual Performance Basis)

(Unit in Billion Won, %)

	1980		1985		1988		1989	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Manufacturing	82.0	67.2	560.0	61.9	2,026.7	75.9	1,829.8	73.3
Construction	0.4	0.3	46.0	5.1	23.9	0.9	82.2	3.3
Transportation, storage & communication	1.7	1.4	80.5	8.9	65.0	2.4	78.0	3.1
Financing, insurance & business services	20.6	16.9	47.2	5.2	149.2	5.6	82.5	3.3
Medical industry	12.9	10.6	59.3	6.6	55.0	2.1	84.6	3.4
Social & personal services	2.5	2.0	53.5	5.9	227.8	8.5	238.2	9.5
Other sectors 1/	2.0	1.6	58.0	6.4	122.4	4.6	99.7	4.0
Total	122.1	100.0	904.5	100.0	2,670.00	100.00	2,495.00	100.0

1/ Agriculture, Forestry, Fishing, Mining, Electricity, Gas, Wholesale & retail trade and Restaurant & hotels.

In the manufacturing sector, the principal long-term financing institutions are the Industrial Bank of Korea, which is a specialized bank, and the Korea Development Bank and the Korea Long Term Credit Bank, which are development institutions. As at the end of 1990, 34.4 per cent of total long-term financing in manufacturing was

Table 7.10

LONG-TERM FINANCING TO THE AGRICULTURE AND MANUFACTURING SECTORS BY INSTITUTIONS 1/

(Unit in Billion Won, %)

	Agricultural sector			Manufacturing sector			All sectors	
	Amount		Percentage of Total	Amount		Percentage of Total	Amount	Percentage of Total
<As at the end of 1987>								
Commercial banks	0.6	(0.0)	-	2,296.3	(77.3)	32.3	2,971.2	17.8
Specialized banks	2,081.0	(27.2)	99.9	2,059.3	(26.9)	29.3	7,659.0	46.1
(Industrial Bank of Korea)	-		-	1,148.1	(97.0)	16.1	1,183.2	7.1
(Citizens National Bank)	7.0	(2.5)	0.3	181.0	(63.5)	2.5	285.0	1.7
(N A C F)	1,809.8	(74.8)	86.9	59.9	(2.5)	0.8	2,419.3	14.5
(N L C F)	263.2	(99.5)	12.6	-		-	264.5	1.6
Non-bank financial institutions	1.3	(0.0)	0.1	2,754.1	(45.9)	38.7	5,998.9	36.1
Korea Development Bank	-		-	2,519.2	(46.3)	35.4	5,435.7	32.7
Korea Long Term Credit Bank	1.1	(0.2)	0.1	214.5	(41.2)	3.0	520.7	3.1
Trust accounts of banks	0.2	(0.5)	-	20.4	(48.0)	0.3	42.5	0.3
Total	2,082.9	(12.5)	100.0	7,109.4	(42.8)	100.0	16,628.8	100.0
<As at the end of 1990>								
Commercial banks	1.9	(0.0)	0.05	4,380.6	(86.0)	38.5	5,093.6	18.4
Specialized banks	3,751.3	(27.8)	99.90	2,425.9	(18.0)	21.3	13,493.3	48.7
(Industrial Bank of Korea)	-		-	1,842.6	(94.0)	16.2	1,959.8	7.1
(Citizens National Bank)	-		-	344.0	(0.0)	3.0	525.2	1.9
(N A C F)	3,432.0	(75.0)	91.40	193.5	(4.2)	1.7	4,573.5	16.5
(N L C F)	319.3	(91.3)	8.50	29.1	(8.3)	0.3	349.8	1.3
Non-bank financial institutions	1.2	(0.0)	0.05	4,578.8	(50.2)	40.2	9,120.1	32.9
Korea Development Bank	-		-	3,920.5	(49.7)	34.4	7,882.1	28.4
Korea Long Term Credit Bank	0.9	(0.0)	-	636.0	(53.8)	5.6	1,182.6	4.3
Trust accounts of banks	0.3	(0.5)	-	22.3	(40.3)	0.2	55.4	0.2
Total	3,754.4	(13.6)	100.0	11,385.3	(41.1)	100.0	27,707.0	100.0

1/ Figures in parentheses represent sectoral shares in aggregate long-term financing by each institution.

supplied by the Korea Development Bank, 16.2 per cent by the Industrial Bank of Korea and 5.6 per cent by the Korea Long Term Credit Bank. Commercial banks also advanced 38.5 per cent of long-term financing, but no individual bank had a prominent share in the overall total. The ratio of long-term financing for manufacturing to total long-term financing by each institution as at the end of 1990 was 94.0 per cent for the Industrial Bank of Korea, 49.7 per cent for the Korea Development Bank and 53.8 per cent for the Korea Long Term Credit Bank. Furthermore, the Export-Import Bank of Korea is the major long-term financing institution for manufacturing. As at the end of 1990, however, its total financing amounted to 2,329 billion won of which 1,268 billion won was allocated to manufacturing. Most of its loans are in the form of long-term financing.

The principal sources of funds of the credit and banking sector of the NACF, which is the major long-term financing institution in agriculture, consisted as of the end of 1990 of deposits (63.7 per cent) and borrowings from government (24.1 per cent). Those of the NICF consisted of deposits (39.4 per cent) and borrowings from the livestock Promotion Fund (23.7 per cent).

The share of deposits and borrowings from government show a constant upward trend for both institutions but no funds were raised from the issue of debentures. The NACF and the NLCF were both established by subscription by nationwide member cooperatives. The subscribed capital of the NACF was 33.6 billion won and that of the NLCF 16.1 billion won, but these figures represent capital of all sectors including economic business sector and not that of their credit and banking sectors alone.

The principal sources of funds of the Industrial Bank of Korea were deposits from the public, which amounted to 47.5 per cent of the Bank's total sources as at the end of 1990. The share of borrowings decreased from 25.5 per cent as at the end of 1985 to 19.3 per cent as at the end of 1990, whereas funds raised by the issue of debentures showed an upward trend, making up 8.5 per cent of the total as at the end of 1990. The Bank's paid-in capital was 217.1 billion won as at the end of 1990, which accounted for 2.0 per cent of its total funds and was almost wholly subscribed by the government.

In the case of the Korea Development Bank, the main sources of funds were foreign loan funds (26.0 per cent) and borrowings from government (15.3 per cent) as at the end of 1980, but as at the end of 1990 deposits in foreign currency (26.6 per cent) and debentures (23.6 per cent) had become more prominent. After the current account shifted into surplus in 1986, the share of borrowings from abroad decreased rapidly, falling to 2.2 per cent as at the end of 1990 from 34.4 per cent as at the end of 1985. The Bank's paid-in capital was 1,241.9 billion won as at the end of 1990, which accounted for 6.4 per cent of its total fund and was wholly subscribed by the government.

Table 7.11

SOURCES OF FUNDS OF THE CREDIT AND BANKING SECTOR OF THE NACF

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Deposits	1,174.4	45.6	2724.1	55.3	9272.2	63.7
Borrowings from	728.6	28.3	1391.2	28.2	4184.4	28.7
(Bank of Korea)	96.7	3.8	79.7	1.6	310.8	2.1
(Government)	338.6	13.1	1099.9	22.3	3517.5	24.1
Others	675.1	26.1	811.0	16.5	1109.7	7.6
Total	2,578.1	100.0	4,926.3	100.0	14,566.3	100.0

Table 7.12

SOURCES OF FUNDS OF THE CREDIT AND BANKING SECTOR OF THE NLCF

(Unit in Billion Won, %)

	Year-end 1983		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Deposits	7.7	3.0	65.9	17.3	419.1	39.4
Borrowings from	247.6	95.8	305.7	80.6	426.7	40.1
(Government)	-	-	14.7	3.9	120.9	11.4
(Livestock Promotion Fund)	243.9	94.4	279.8	73.8	252.2	23.7
Others	3.2	1.2	7.5	2.1	217.3	20.5
Total	258.5	100.0	379.1	100.0	1,063.1	100.0

Table 7.13

SOURCES OF FUNDS OF THE INDUSTRIAL BANK OF KOREA

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Deposits	841.0	58.8	2,150.0	50.7	5,282.8	47.5
Borrowings from	332.4	23.3	1,082.6	25.5	2,070.7	19.3
(Bank of Korea)	87.1	6.1	695.5	16.4	1,046.0	9.8
(Government)	13.4	0.9	42.4	1.0	289.9	2.7
Debentures issued	-	-	202.6	4.8	904.9	8.5
Paid-in capital	57.1	4.0	167.1	3.9	217.1	2.0
Others	198.6	13.9	640.8	15.1	2,432.8	22.7
Total	1,429.1	100.0	4,243.1	100.0	10,708.3	100.0

Table 7.14

SOURCES OF FUNDS OF THE KOREA DEVELOPMENT BANK

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Deposits	135.8	3.3	198.5	1.8	846.0	4.3
Deposits in foreign currency	31.1	0.8	36.4	0.3	5,182.8	26.6
Borrowings from	2,533.3	62.5	6,809.9	60.6	3,517.1	18.0
(Government)	618.8	15.3	1,496.8	13.3	1,821.6	9.9
(Abroad)	1053.5	26.0	3859.9	34.4	430.5	2.2
Debentures issued	510.4	12.6	1,710.5	15.2	4,611.5	29.6
Paid-in capital	505.3	12.5	615.7	5.5	1,241.9	6.4
Others	340.6	8.4	1,864.4	16.6	4,102.2	21.1
Total	4,056.5	100.0	11,235.4	100.0	19,501.5	100.0

The Korea Long Term Credit Bank had relied heavily until the mid-1980s for its sources of funds on borrowings from international financial institutions such as IBRD and ADB. But after the turnabout in the current account balance in 1986, this source was largely replaced by debentures, which made up 42 per cent as of the end of 1990, and by deposits in foreign currency, which by then accounted for 12.6 per cent of funds raised. The Bank's paid-in capital was 172.0 billion won as of the end of 1990, and 84 per cent of this was subscribed by domestic companies and financial institutions, with the remaining 16.0 per cent being invested by foreign financial institutions, but with no government stake.

The principal sources of funds of the Export-Import Bank of Korea were borrowings in foreign currency, which amounted to 35.2 per cent of the Bank's total sources as at the end of 1990. The share of borrowings decreased from 56.3 per cent as at the end of 1985 to 11.4 per cent as at the end of 1990, whereas funds raised by the issue of debentures in foreign currency showed an upward trend, making up 14.1 per cent of the total as at the end of 1990. The Bank's paid-in capital was 540.9 billion won as at the end of 1990, which accounted for 20.0 per cent of its total funds and was subscribed by the Bank of Korea (47.2 per cent), the government (32.2 per cent), and the Korea Exchange Bank (20.5 per cent). The amount of sources of funds have decreased since 1985 in this Bank.

1.3 Lending Policies and Procedures

There are differences in the long-term lending policies for the two sectors according to the institutions involved. Commercial banks handle policy-directed loans whose conditions and eligibilities are predetermined by government. In the case of policy-directed loans, the funds are supplied to particular sectors in accordance with economic policy priorities rather than banks' credit policies. But they also extend general long-term loans on the basis of their own judgment and these loans are generally supplied for equipment investment of firms though there exist slight differences in lending policies depending on individual banks.

Specialized banks, established according to a series of separate Acts, provide funds to their own priority sectors, which would otherwise experience difficulties in raising funds through commercial channels.

Table 7.15

SOURCES OF FUNDS OF THE KOREA LONG TERM CREDIT BANK

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Deposits	9.0	2.0	28.7	2.1	299.8	6.0
Deposits in foreign currency	-	-	-	-	628.0	12.6
Borrowings	1.8	0.4	4.9	0.4	599.9	12
Borrowings in foreign currency	253.5	56.3	596.5	44.2	316.8	6.3
Debentures issued	59.2	13.1	528.3	39.2	2,098.6	42.0
Paid-in capital	50.0	11.1	50.0	3.7	172.0	3.4
Others	76.7	17.1	140.0	10.4	885.5	17.7
Total	449.1	100.0	1,348.4	100.0	5,000.6	100.0

Table 7.16

SOURCES OF FUNDS OF THE EXPORT-IMPORT BANK OF KOREA

(Unit In Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Borrowings	312.8	56.3	597.3	12.5	307.2	11.4
Borrowings in foreign currency	-	-	1,344.5	28.1	950.2	35.2
Proceeds of disposed P/N	6.4	1.2	1579.1	33	145.9	5.4
Debentures issued in foreign currency	-	-	369.9	7.7	380.9	14.1
Paid-in capital	179.1	32.2	427.9	8.9	540.9	20.0
Others	57.3	10.3	467.8	9.8	376.9	13.9
Total	555.6	100.0	4,786.5	100.0	2,702.0	100.0

Development institutions supply long-term financing in accordance with government economic policy for the development and fostering of major industries and for the support of specific sectors. Such objectives would not be readily compatible with the operation of general banking institutions.

Table 7.17

SPECIALIZED BANKS

	Purpose of Establishment	Year Established	Relevant Legislation
The Industrial Bank of Korea	Financial support for small and medium firms	1961	Industrial Bank of Korea Act
The Citizens National Bank	Financial support for households and small firms	1963	Citizens National Bank Act
The Korea Housing Bank	Finance and supply of housing funds	1969	Korea Housing Bank Act
The Credit and Banking Sector of the NACF 1/	Promotion of agricultural productivity	1961	Agricultural Cooperatives Act
The Credit and Banking Sector of the NFFC 2/ and Member Cooperatives	Promotion of the Productivity of fisheries	1962	Fisheries Cooperatives Act
The Credit and Banking Sector of the NLCF 3/	Development of the livestock industry	1981	Livestock Cooperatives Act

1/ NACF - National Agricultural Cooperative Federation
2/ NFFC - National Federation of Fisheries Cooperatives
3/ NLCF - National Livestock Cooperative Federation

Table 7.18

DEVELOPMENT INSTITUTIONS

	Purpose of Establishment	Year Established	Relevant Legislation
The Korea Development Bank	Provide and manage funds for major industries	1954	Korea Development Bank Act
The Export-Import Bank of Korea	Financial support for export, overseas investment, and overseas resources development	1976	Export-Import Bank of Korea Act
The Korea Long Term Credit Bank	Encourage and foster long-term financing for private businesses	1980	Long Term Credit Bank Act

Conditions of long-term loans for the two sectors vary according to the type of funds. Policy-directed long-term loans are supplied to specific areas which are neglected by commercially-based long-term financing. And in the case of general long-term financing, there are no special restrictions on lending, except on the extension of credit to prohibited sectors designated by the Bank of Korea. Interest rates on policy-directed long-term loans are mostly 5.5 per cent - 12.4 per cent and their term is from 3 to 35 years. These conditions are favourable compared with general long-term loans. The term of general long-term loans is within ten years and the interest rates on them was deregulated after December 1988.

There are no special guarantee institutions exclusively concerned with long-term financing for either of the two sectors. But the Credit Guarantee Fund for Agriculture, Forestry, and Fishery provides credit guarantees in connection with loans by the NACF, the NFFC, or the NLCF. The Fund was established jointly by the government and the above organizations in 1972. This fund was set up within the NACF which takes charge of its management. As at the end of 1990, its outstanding guarantees registered 1,149 billion won.

The Korea Credit Guarantee Fund, the Korea Technology Credit Guarantee Fund and banking institutions extend credit guarantees in connection with loans provided by financial institutions. The Korea Credit Guarantee Fund was established in 1976 under the Credit Guarantee Fund Act for the purpose of extending credit guarantees for the liabilities of business enterprises which generally suffer from a lack of adequate collateral. The Fund's financial resources are raised through contributions from the government and banking institutions. Its main business consists of extending credit guarantees, providing credit information, giving managerial and technical assistance, and participating in capital investment in small and medium firms. As at the end of 1990, its outstanding guarantees registered 5,230.6 billion won. Credit guarantees for manufacturing sector amounted to 3,803.9 billion won, accounting for 72.7 per cent of the total.

The Korea Technology Credit Guarantee Fund was founded in 1987 under the New Technology Enterprise Financial Support Act for the purpose of extending credit guarantees, mainly for the liabilities arising from the adaption and application of newly developed technologies to commercial production. The Fund was separated from

Table 7.19

LOAN CONDITIONS OF MAJOR LONG-TERM FINANCING
(As at the end of 1990)

	Eligibility	Financial Institu- tions 1/	Interest Rates (percent p.a.)	Term 2/ (years)
Policy-directed Long-term Financing				
Agricultural mechanization funds	Person who seeks to purchase or produce agricultural machinery	NACF	8	3-9(1)
Rural housing funds	Person who seeks to construct or improve rural housing	NACF	8	20(5)
Irrigation funds	Farmland Improvement Association or Rural Development Corporation	NACF	5.5	35(5)
Young prospective farmer support funds	Young prospective farmer selected by local government	NACF	5	7-10(4)
Integrated development funds	Person who seeks to improve production infrastructure in agriculture or to purchase agricultural machinery or to process agricultural products	NACF	8	3-9(3)
Technology development funds	Person who will enter the business using new domestic technology or imported technology	KDB	11.4-12.4	8(3)
Machinery localization funds	Person purchasing domestic machinery from domestic producer as industrial equipment	KDB	11.4-12.4	10(3)
Ship-building funds	Person requiring funds for ship-building	KDB	11.4-12.4	13(3)
Medium and long-term deferred-payment export funds	Person who exports industrial plant, ships, or rail rolling stock and its parts	EXIM	9-10.5	10(2)
Foreign investment funds	Funds for the acquisition of raw materials and resources or to explore export-import markets	EXIM	8	10(3)
Technology development funds for small and medium firms	Funds for research and development of new products or start-up funds for business using imported technology	Commercial and specialized banks	10.5	10(3)
Small and medium firms' equipment funds for the prevention of environmental pollution	Equipment funds for the prevention of environment pollution as determined by the Environment Preservation Act	Commercial banks, IBK, CNB	10.5	10(3)

Table 7.19 (Cont'd)

	Eligibility	Financial Institutions 1/	Interest Rates (percent p.a.)	Term 2/ (years)
National investment funds	Person purchasing domestic machinery or who needs ship building funds or who needs the defense industry funds	All banks except KHB and EXIM	10.5	10(3)
Industry development funds	Small and medium firms selected as industrial technology improvement businesses	IBK, KDB, KLB	6-6.5	8(3)
Funds for energy saving equipment	Funds for enhancing the efficiency of energy use	All banks except EXIM	5-10	8(3)
Industry structure coordination funds	Person seeking equipment fund in accordance with the standards set by Industrial Policy Council	KDB, IBK	5	10(5)
General Long-term Financing				
General funds	No special restrictions except on the extension of credit to prohibited sectors designated by the Bank of Korea	All banks	Deregulated	10
Trust funds	No special restrictions except on the extension of credit to prohibited sectors designated by the Bank of Korea	All banks	Deregulated	10
Foreign currency funds	Equipment funds according to the Regulation on Foreign Currency Loan and Deposits established by the Monetary Board of the Bank of Korea	Foreign exchange banks	LIBOR+1.0	10
Customer finance	Producer purchasing industrial equipment or materials from other producer	All Banks except development institutions	Deregulated	No limit
Medium-term finance of merchant banking corporation	No special restrictions	Merchant banking corporations	Deregulated	No limit
General loans of life insurance companies	Insurance policyholder	Life insurance companies	Deregulated	10

1/ NACF - National Agricultural Cooperative Federation
KDB - The Korea Development Bank
IBK - The Industrial Bank of Korea
CNB - The Citizens National Bank
KHB - The Korea Housing Bank
KLB - The Korea Long Term Credit Bank
EXIM - The Export-Import Bank of Korea

2/ Figures in parentheses represent the maximum grace period. For general financing, this period is usually one third of the overall term of the loan.

the Korea Guarantee Fund according to the revision of this Act in December 1988 in order to provide special financial services for competitiveness in credit guarantee business. The Fund's sources of finance are contributions from the government and banking institutions as in the Korea Credit Guarantee Fund. Its main operational activities are similar to those of the Korea Credit Guarantee Fund, apart from the technology credit guarantees for the development of new technologies, which are handled only by this Fund. As at the end of 1990, its outstanding guarantees stood at 864 billion won, of which 755 billion won was alloted to guarantees for manufacturing sector.

Table 7.20

OUTSTANDING BALANCE OF THE CREDIT GUARANTEE FUND FOR AGRICULTURE, FORESTRY, AND FISHERY'S GUARANTEES

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Agriculture	82.4	92.2	318.0	90.3	1,084.9	94.4
Fishery	7.0	7.8	21.1	6.0	50.7	4.4
Livestock	-	-	13.2	3.7	13.6	1.2
Total	89.4	100.0	352.3	100.0	1,149.2	100.0

Table 7.21

OUTSTANDING BALANCE OF THE KOREA CREDIT GUARANTEE FUND'S GUARANTEES

(Unit in Billion Won, %)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	Percentage of Total	Amount	Percentage of Total	Amount	Percentage of Total
Agriculture 1/	-	-	1.1	0.1	13.5	0.3
Manufacturing	893.8	71.2	1,338.6	70.6	3,803.9	72.7
Other sectors	361.8	28.8	555.8	29.3	1,413.1	17.0
Total	1,255.2	100.0	1,895.5	100.0	5,230.6	100.0

1/ Sum of Agriculture, Forestry, and Fishery.

II. The Role of the Central Bank in Long-Term Financing for the Manufacturing and Agricultural Sectors

2.1 Financing Facilities of the Central Bank

Although the support system of the Bank of Korea provides no grants, direct financing, special interest rates or interest exemptions for manufacturing and agriculture, the Bank of Korea, indirectly, supports long-term financing by refinancing, in part, the funds of banking institutions. This is done in order to induce financial support to those specific sectors which are important for the whole economy.

The Bank of Korea's refinancing system for the two sectors is shown in Table 7.22. As may be seen, the Bank of Korea refinances part of the long-term financing of commercial banks and specialized banks. Where this occurs, the rediscount rate is 3-7 per cent and the ratio of refinance ranges between 50-100 per cent of the funds advanced by the banks. But the Bank of Korea does not provide any support for advances by development institutions or other non-bank financial institutions.

Table 7.22

PRINCIPAL SUPPORT SYSTEM OF THE BANK OF KOREA FOR LONG-TERM FINANCING

(As at the end of 1990)

	Banks	Annual Interest Rates (%)	Term (year)	Ratio of Refinancing by Central Bank	Annual Rediscount Rates (%)	Outstanding Balance of the Bank of Korea's Support (billion won)
Loans to small and medium firms						
- Technology development funds	Commercial and specialized banks	10.5	10	50% of funds advanced	7	6.3
- Equipment funds for prevention of environment pollution	Commercial banks, IBK, CNB	10.5	10	50% of funds advanced	7	1.2
Equipment funds for export industries and industries producing basic materials and parts for import substitution	Commercial banks, IBK	10.5	10	60% of funds advanced	7	756.2
Support funds for industrial structure adjustment 1/	Nationwide, commercial and specialized banks	5.0	10	100% of funds advanced	3	1563.5

1/ Includes support funds provided to farming and fishing households to replace privately-incurred liabilities.

2.2 Regulations

The Bank of Korea has drawn up various regulations governing the credit operations of financial institutions whereby it prohibits loans to certain designated sectors and attempts to channel the supply of banking funds to the important sectors deemed essential for economic growth and promote a balanced allocation of credit. The Bank of Korea also influences interest rates through its regulations concerning maximum interest rates on loans and deposits.

These regulations cover commercial banks and some specialized banks, but do not directly apply to development institutions and other non-bank financial institutions. Development institutions and other non-bank financial institutions are subject to the provisions of the particular Acts under which they were established or the regulations of the Ministry of Finance. This means that in providing long-term finance to the two sectors, financial institutions must comply with the pertinent regulations of the Bank of Korea, and the Ministry of Finance, and the provisions of the Acts under which they were established.

2.3 Supervision Problems

Although the Bank of Korea does not specifically supervise and control the long-term financing extended by individual financial institutions to the agricultural and manufacturing sectors, it exercises control over the long-term financing through its general supervision of the overall business of commercial banks and some specialized banks.

As shown in Table 7.23, the Bank of Korea supervises commercial banks and some specialized banks. And the Ministry of Finance supervises the other specialized banks and development institutions and other non-bank financial institutions. The Bank of Korea examines the banking business of certain specialized banks and other financial institutions under the authority delegated to it by the Minister of Finance, but does not have the power of supervision.

The Bank of Korea does not involve itself in analyzing project proposals submitted by the borrowers, nor conducting field inspection or recommending loans. It is, however, indirectly involved in the long-term financing of the Korea Development Bank, a major long-term financing institution for manufacturing, through the Monetary Board's consultancy work on the annual business plan of the Korea Development Bank.

Table 7.23

SUPERVISION OF FINANCIAL INSTITUTIONS

	Supervised by	Examined by
Commercial Banks & Specialized Banks 1/	The Bank of Korea	Superintendent of Banks of the Bank of Korea
Specialized Banks 2/	Ministry of Finance	Board of Audit and Inspection, Superintendent of Banks of the Bank of Korea
Other Financial Institutions	Ministry of Finance	Board of Audit and Inspection, Minister of Finance, Superintendent of Banks of the Bank of Korea

1/ The credit and banking sector of the NACF, The credit and banking sector of the NFFC and member cooperatives, The credit and banking sector of the NLCF.

2/ The Industrial Bank of Korea, The Citizens National Bank, The Korea Housing Bank.

2.4 Implications for the Central Bank

The Bank of Korea participates indirectly in long-term financing through its supply of funds to financial institutions which provide special long-term financing. Therefore, there is no problem over delays in long-term financing procedures due to the participation of the Bank of Korea. The Bank of Korea does not involve itself directly in long-term financing with the motive of reducing the risk of default. It is considered that risk can be minimized by strengthened credit screening by individual banks providing the funds and the more active use of guarantee institutions rather than through its direct involvement.

The long-term financing extended by the specialized banks, the development institutions and other financial institutions are under the control of the Minister of Finance whereas the commercial banks and some specialized banks are under the control of the Bank of Korea. Thus, it is apparent that there is no comprehensive system arranged for the overall regulation of long-term financing.

III. Issues and Suggestions in Long-Term Financing for Manufacturing and Agricultural Sectors

3.1 Issues Related with Long-Term Institutional Credit

In Korea, there exist some factors restraining long-term financing for the two sectors. Firstly, policy-directed long-term financing accounts for a large part of long-term financing for the two sectors. In policy-directed long-term financing, the eligibility and the amount of the funding are determined by the government. And these factors restrict the exercise of the credit evaluation capabilities of financial institutions and caused individual institutions to neglect follow-up management of the loan. Furthermore, there is no adequate provision for increasing the efficiency of lending to specific sectors through coordination among financial institutions, because each financial institution undertakes its long-term financing for the two sectors individually.

Secondly, commercial banks undertake policy-directed long-term financing, although they lack instruments for the raising of long-term funds. So they raise their funds for long-term financing through the acceptance of short-term liabilities. This makes it very difficult for them to match their sources and uses of funds. Most specialized banks, which have a large share of long-term financing in their aggregate financing, also have difficulty in raising funds for long-term financing.

Thirdly, there is an excess demand for long-term financing in the manufacturing sector because of continual high economic growth rate in excess of the potential growth rate. For agriculture, the supply of long-term financing available through financial institutions has typically fallen short of the demand. For example, only 27.3 per cent of the investment funds for fixed assets formation in 1987 was provided by long-term financing from financial institutions, the remainder being funded through short-term financing and private liabilities.

The policies and procedures with regard to the repayment of the long-term financing for the two sectors vary according to the financial institutions and the kind of funding provided. Under the General Banking Act, loans by commercial banks with maturities in excess of three years should be repaid on a regular installment basis with interval between payments of no longer than one year.[3]

In the case of loans by specialized banks and development institutions, repayment is made on a regular installment basis or through a lump sum payment according to the individual institution's rules. And in general, most long-term loans with maturities in excess of three years granted by banking institutions allow a grace period which is generally one third of the term of the loan. Repayment problems such as loan defaults or loan delinquency cannot be researched for the two sectors specifically because of the lack of statistical data.

Table 7.24

BREAKDOWN OF FARMING HOUSEHOLDS' FIXED ASSET INVESTMENT BY SOURCE

(Unit in Per Cent)

	Organized Financing		Unorganized Financing	Total
	Long-term	Short-term		
1983	30.4	58.3	11.3	100.0
1984	27.4	58.7	13.9	100.0
1985	32.1	50.3	17.6	100.0
1986	37.1	55	7.9	100.0
1987	27.3	62.5	5.2	100.0

3/ Article 21, the General Banking Act stipulates that (1) The term "Long-term Financing Business" as used in this Act shall be defined as the operations involving the lending of funds, acquired predominantly from capital subscriptions, the acceptance of deposits with maturities of at least one year or the issue of bonds or other securities, for periods not exceeding ten years, or for periods of more than ten years and not exceeding fifteen years, within the maximum amount which the Monetary Board may fix in relation to the total liabilities of the pertinent banking institution. (2) Among the loans specified in Paragraph (1), repayment of such loans with maturities in excess of three years shall be made on a regular installment basis with the payment interval not exceeding one year. In the case of a loan for a project which does not begin to yield a return in a specified period of time, repayment may be postponed during that period.

3.2 Future Needs of Long-Term Financing for Manufacturing and Agricultural Sectors

As pointed out earlier, the growth of long-term financing for both sectors outpaced that of total financing during 1980-1990. And the needs of long-term financing for the two sectors are expected to increase continuously. Firstly, the future needs of long-term financing for agriculture will increase because of rapid mechanization and an increase in farm-size in order to overcome the shortage of labor. Strengthening of structural adjustment in the face of external pressure for opening the domestic agricultural produce markets through multilateral or bilateral negotiations and the growing requirements for greater welfare and improvement of the rural environment will also boost the future needs for long-term financing.

Secondly, the future needs of long-term financing for manufacturing will increase because the government has changed the current credit supervision system to strengthen the competitiveness of the manufacturing sector. To facilitate investment in order to commercialize advanced technology and to improve international competitiveness will also increase the future needs for long-term financing in manufacturing.

3.3 Recommendations for Further Improvements

When we take into account the factors restraining the long-term financing for the two sectors, it appears necessary to prepare some reform measures in order to increase the allocative efficiency of lending and to enlarge the supply of long-term financing. Firstly, in the case of policy-directed long-term financing, it is desirable that the authorities set only the fundamental guidelines while the selection of the loan target and the basis for loan allocations must be decided by individual institutions. This will enable the institutions providing policy-directed long-term financing to improve their techniques of credit evaluation. In the long-run, it is desirable to reduce policy-directed long-term financing. And the specialized banks, rather than commercial banks, should undertake the policy-directed financing for priority sectors, where this is necessary.

Secondly, the efficiency of loan allocation can be maximized in long-term financing to specific sectors in line with the following recommendations. The institutions involved in the provision of long-term financing, should jointly organize support funds and coordinate the follow-up management of long-term financing.

Table 7.25

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS 1/
(Outstanding Balance)

(Unit in Billion Won, %)

Year-end	Long-term Financing 2/			Total Financing 3/		
	Agricultural Sector	Manufacturing Sector	All Sectors	Agricultural Sector	Manufacturing Sector	All Sectors
1981	593.9	2,089.2	5,306.2	976.5	12,593.8	22,765.7
	(35.3)	(28.5)	(27.6)	(28.6)	(30.9)	(31.9)
1982	748.2	2,586.2	6,954.1	1,129.1	14,405.7	28,637.7
	(25.9)	(28.6)	(31.1)	(15.7)	(14.4)	(25.4)
1983	1,049.7	2,918.5	8,734.1	1,537.1	16,211.4	34,540.8
	(40.4)	(12.8)	(25.6)	(36.1)	(12.5)	(20.6)
1984	1,347.2	3,180.9	10,015.4	1,992.6	19,527.7	42,307.5
	(28.3)	(9.0)	(14.7)	(29.7)	(20.5)	(22.6)
1985	1,608.2	3,845.2	11,730.9	2,341.4	22,902.2	50,674.1
	(19.4)	(20.9)	(17.1)	(17.5)	(17.3)	(19.9)
1986	1,833.1	5,960.3	14,394.3	2,705.9	27,355.1	59,553.0
	(14.0)	(55.0)	(22.7)	(15.6)	(19.4)	(17.6)
1987	2,082.9	7,109.4	16,628.8	3,721.4	31,426.3	68,601.5
	(13.6)	(19.3)	(15.5)	(37.5)	(14.9)	(15.3)
1988	2,634.5	8,334.9	19,022.1	4,442.1	35,574.7	79,125.3
	(26.5)	(17.2)	(14.4)(	19.4)	(13.2)	(15.3)
1989	3,110.4	9,547.7	22,240.1	5,217.6	44,399.8	102,628.6
	(18.0)	(14.6)	(16.9)	(17.4)	(24.8)	(29.8)
1990	3,754.4	11,385.3	27,707.0	6,355.8	55,090.1	125,201.1
	(20.7)	(19.2)	(24.6)	(21.8)	(24.1)	(22.0)

1/ Figures in parentheses represent the sectoral growth rates.

2/ Loans with maturities of over one year. Long-term loans by the Export-Import Bank of Korea, merchant banking corporations, and life insurance companies are not included because of the lack of statistical data.

3/ Supplied by commercial banks, specialized banks, development institutions, investment and finance companies, merchant banking corporations, trust accounts of banks, and life insurance companies.

Thirdly, it is desirable for commercial banks to expand the long-term financing business to cope with the increase in future needs of long-term financing for both sectors. Two concrete proposals to enlarge the long-term financing business of commercial banks would be to permit the commercial banks to issue debentures and to lengthen the maximum period of loans.

Lastly, it is desirable for specialized banks and development institutions to strengthen their capacity of long-term financing through preferential treatment in interest or tax for their customers in the raising of long-term funds.

IV. Major Findings and Concluding Remarks

In Korea, all banking institutions, comprising commercial banks, specialized banks, and development institutions, take part in long-term financing for the manufacturing and agricultural sectors. Besides the banking institutions, merchant banking corporations, trust accounts of banks, and life insurance companies also engage in long-term financing business.

Observing the long-term financing for both sectors during 1980-1990, we find that the ratio of long-term financing for the agricultural sector to aggregate long-term financing increased from 11 per cent as at the end of 1980 to 14 per cent as at the end of 1990. That of the manufacturing sector had decreased in the early 1980s but increased again from 1985 to stand at 41 per cent as at the end of 1990. Meanwhile, the ratios of long-term financing in the two sectors to GNP, total exports, and value added have increased steadily during 1980-1990.

When we observe the contribution of the two sectors to employment, contribution of manufacturing is considerable whereas agriculture made a negative contribution. But the sectoral contribution of manufacturing was lower than that of other sectors. In the same way, when we observe the contribution to exports of the two sectors, the contribution of manufacturing is significant but, those of agriculture and other sectors are very small.

Apart from the financial institutions mentioned above, the NACF's economic business department is regarded as the main institution involved in the development of the agricultural sector. As in manufacturing, leasing companies and venture capital companies are counted as institutions involved in the financing of manufacturing.

When we examine the long-term financing institutions by breaking down long-term financing as at the end of 1990 by institutions and industries, it can be noted that the credit and banking sectors of the NACF and the NLCF, which are specialized banks, are the major long-term financing institutions for agriculture. In the manufacturing sector, the principal long-term financing institutions are the Industrial Bank of Korea, which is a specialized bank, and the Korea Development Bank and the Korea Long Term Credit Bank and the Export-Import Bank of Korea, which are development institutions.

The principal sources of funds of the credit and banking sector of the NACF consisted, as at the end of 1990, of deposits and borrowings from government. Those of the NLCF consisted of deposits and borrowings from the Livestock Promotion Fund. In the manufacturing sector, the principal sources of funds of the Industrial Bank of Korea were deposits from the public. And its pattern of sources of funds is similar to that of commercial banks. In the case of the Korea Development Bank, the main sources of funds were borrowing from abroad and borrowings from government as at the end of 1980, but as at the end of 1990 deposits in foreign currency and debentures had become more prominent. Paid-in capital of the two institutions, which accounted for 2 per cent and 6 per cent of total funds respectively, was almost wholly subscribed by the government. However, the Korea Long Term Credit Bank, whose capital was subscribed by domestic companies and foreign financial institutions, has relied its sources of funds on debentures and on deposits in foreign currency since the turnabout in the current account balance in 1986. In the case of the Export-Import Bank of Korea, the principal sources of funds were borrowings in foreign currency and paid-in capital. And paid-capital of this institution, which accounted for 20 per cent of total funds, was subscribed by the Bank of Korea, the Government, and the Korea Exchange Bank.

There are differences in long-term lending policies for the two sectors according to the institutions involved. Commercial banks extend policy-directed loans whose conditions and funding sector are predetermined by government. But they also handle general long-term loans on the basis of their own judgment. And most general long-term loans are supplied for equipment investment of firms. Specialized banks, established according to a series of separate Act, provide funding to the priority sectors, which would otherwise experience difficulties in raising funds through commercial channels. Development institutions supply long-term financing in accordance with government economic policy for the development and fostering of major industries and for the support of specific sectors.

Long-term loan conditions in the two sectors vary according to the type of funds supplied. Policy-directed long-term loans are supplied to specific areas which are neglected by commercially-based long-term financing. And in the case of general long-term financing, there are no special restrictions on lending except on the extensions of credit to prohibited sectors designated by the Bank of Korea. The conditions of policy-directed long-term loans are, by and large, favorable compared with general long-term loans.

The Bank of Korea provides no grants, direct financing, preferential interest rates or interest exemptions specifically for manufacturing and agriculture. But the Bank of Korea indirectly supports long-term financing by refinancing, in part, the funds of commercial banks and specialized banks.

The Bank of Korea has drawn up various regulations governing the credit operations of financial institutions which, inter alia, set out the eligibility of financial advances. In addition, the Bank of Korea also influences interest rates through its regulations concerning maximum interest rate on loans and deposits. These regulations cover commercial banks and specialized banks. But the operations of development institutions and other non-bank financial institutions are subject to the provisions of the particular acts under which they were established and the regulations of the Ministry of Finance.

Although the Bank of Korea does not specifically supervise and control the purely long-term financing extended by individual institutions, it exercises control over long-term financing through its general supervision of the overall business of commercial banks and some specialized banks. And the Minister of Finance supervises the other specialize banks, the development institutions and other non-bank financial institutions.

In Korea, there exist some factors restraining long-term financing for the two sectors. Firstly, policy-directed long-term financing accounts for a large part of long-term financing. In this case, the eligibility and the amount of the loans are determined by the government and this restricts the exercise of credit evaluation capabilities of individual institutions. For the above reasons, the allocative efficiency of long-term financing for both sectors is low. Secondly, commercial banks undertake policy-directed long-term financing, although they lack instruments for the raising of long-term funds. And most specialized bank also have difficulty in raising of long-term financing. All these factors restrict the enlargement of the long-term financing business of banking institutions. Thirdly, there is an excess demand for long-term financing in the manufacturing sector. And in agriculture, the supply of long-term financing available through financial institutions falls short of demand. Moreover, constant expansion of the needs of long-term financing for the two sectors is foreseen.

When we take into account the factors restraining long-term financing for the two sectors, it appears necessary to prepare some reform measures in order to increase the efficiency of allocating lending and to enlarge the supply of long-term financing. Firstly, it is desirable that the authorities set only the fundamental guidelines while the selection of loan targets and the basis for loan allocations must be decided by individual institutions in the case of policy-directed long-term financing. In the long-run, it is desirable to reduce policy-directed long-term financing. Secondly, the institutions involved in the provision of long-term financing should jointly organize support funds and coordinate follow-up management. Thirdly, it is desirable to permit the commercial banks to issue debentures and to lengthen the maximum period of loans, so as to enlarge the long-term financing business of the commercial banks. In addition, in the case of specialized banks, the existing system for the raising of funds needs to be supplemented, in order to strengthen their capacity to provide long-term financing.

Chapter 8

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN MALAYSIA

by

Fatimah Yahya

I. An Overview of the Existing Conditions of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Nature of Long-Term Financing for the Manufacturing and Agricultural Sectors[1]

1.1.1 Overview

The Malaysian financial system, may be divided analytically into two parts, the banking system and the non-bank financial intermediaries. The banking system basically comprises the commercial banks, the finance companies, the merchant banks and the discount houses and were supervised by the Central Bank. On the other hand, the non-bank financial intermediaries, which are supervised by various Government departments and agencies, may be divided broadly into five groups of institutions, namely, the development finance institutions (DFIs), the savings institutions, the provident and pension funds, the insurance companies and a group of other financial intermediaries. In Malaysia, all financial institutions and non-bank financial intermediaries extend long-term financing to both the manufacturing and agricultural sectors in addition to other sectors in the economy.

Banking System

The commercial banks, since their establishment have been concentrating their credit activities in the financing of trade and to a smaller extent, investment goods. This traditional pattern of lending, however, had changed significantly over time reflected by the substantial increase

---

1 Long-term loans in this paper are defined as loans with maturities of over one year.

in the amount of loans and advances to finance manufacturing activities in line with the rapid pace of industrialisation in the country. This was attributable partly by the calls made by the Government especially the Central Bank, for the banking institutions to play a more proactive roles towards the achievement of the nation's development objectives. In this regard, banks were asked to be more development-oriented and to change their attitudes, approaches and lending policies in accordance with the changing needs of the country. Hence as the agricultural diversification and industrialisation process gathered momentum under the country's five-year development programmes, the character and direction of banks' credit reflected the economic transformation. Another interesting point to note in the evolution of commercial banks' lending was the lengthening of the maturity structure of their credit, which had resulted in commercial banks stepping up their term lending. The finance companies in Malaysia are the second largest mobilisers of deposit funds in the country and also the second most important institutional source of private sector credit after the commercial banks. Credit extended by the finance companies had tended to reflect the short to medium-term nature of loans, mainly for acquisition of fixed assets and working capital, hire purchase and leasing facilities. As such, more than a quarter of loans granted by the finance companies was extended to private individuals especially for hire-purchase loans for consumer durables. Realising this phenomenon, the Central Bank had in their capacity, urged the finance companies to direct their lending activities towards the provision of more medium and long-term loans to finance the modernisation of agricultural and industrial development. This had resulted in a discernible change in the direction of finance companies' credit which had became more diversified to also include financing for housing, building and construction, real estate development and also agriculture. To ensure that credit expansion was in line with the objectives of the national policy, broad credit guidelines were first introduced in 1975 for the finance companies. The emergence of merchant banks to complement and supplement the activities provided by the existing financial institutions coincided with the adoption of the Second Malaysia Plan. Merchant banks in Malaysia are licensed to operate as specialised financial intermediaries in the money and capital markets. Since their establishment in early 1970s, the merchant banks have expanded their scope of operations in the financial system by providing a wide range of specialised services, such as underwriting facilities, corporate financing, financial investment, management advice and portfolio investment management.

Industrial Finance Institutions

The industrial finance institutions (IFIs) are specialised group of financial institutions set up to promote a higher level of investment in industries and agriculture. This group of institutions comprises the Malaysian Industrial Development Finance (MIDF), Sabah Development Bank (SDB), Industrial Bank of Malaysia (IBM), Development Bank of Malaysia (DBM) and the Borneo Development Corporation (BDC). The IFIs was set up to fill the gap in the supply of financial services that were not usually covered by the established financial institutions, as well as to overcome the problem of the tendency of the banking system to extend credit to the larger entrepreneurs with high credit standing. The specialised roles of the IFIs were in the provision of medium and long-term financing and other financial services to the small and medium-scale entrepreneurs. The availability of funds which was made up of the shareholders' funds and borrowings from the Government, as well as other domestic and foreign financial institutions had been an important factor governing the IFIs' loan operations. Almost two-thirds of the IFIs funds were disbursed in the form of loans to the industrial and agricultural sectors.

The lending activities of the IFIs moved in tandem with the growing economy. The IFIs were responsible in channelling credit facilities through various loan schemes. The World Bank loan scheme for small-scale industries ($210 million) was administered by both the MIDF and DBM. In addition, the MIDF also administered the Enterprises Rehabilitation Fund (ERF), a revolving fund on behalf of the Central Bank. Loans by SDB were more varied covering financing of the agriculture, manufacturing, utilities and the construction and real estate sectors, while loans by MIDF, DBM and BDC were primarily for the industrial sector. Initially the credit operations of IBM were more specialised, mainly for the development of the shipping industries, for which credit from the banking system was not readily available. Consonant with the country's industrialization programme, Bank Industri or IBM had increasingly given more emphasis on the development of high technology, capital-intensive and export-oriented industries as well as the engineering sector. To create new business activities, Bank Industri had set up a venture capital operation with a United States-based company called the Walden Group in 1990. The company was committed to invest in a semiconductor manufacturing project to produce integrated circuit chips. In addition, Bank Industri had also launched a Technical Consultancy

Programme in 1990 to assist small and medium-scale enterprises engaged in manufacturing activities especially in the technical aspects of operations, such as quality assurance and control, machine utilisation and also design and production process, particularly those owned and operated by Bumiputeras. The Import Trade Financing facility of the Islamic Development Bank (IDB) of Jeddah, of which Bank Industri has been acting as an executing agent since 1986, was extended to Malaysian manufacturers for the importation of raw materials and intermediate goods. Bank Industri, as the executing agent, had also arranged for the exportation of palm oil, plywood and sawntimber to the Middle East under the Longer Term Trade Financing facility (LTTF) of the IDB of Jeddah. LTTF is a post-shipment export credit scheme designed to promote trade among the Organisation of Islamic Countries (OIC) through the financing of non-traditional exports of participating member countries to other OIC member countries. A brief outline of the IFIs is shown in Appendix 8.1.

Agricultural Credit Institutions

In addition to the banking system, the rural credit institutions were also involved in the long-term financing for the agricultural sector. The rural credit institutions which mainly consist of the rural co-operative societies, farmers' associations, Agricultural Bank and Bank Rakyat were mainly agro-based institutions. The role of the rural co-operative societies were complemented by the Bank Rakyat, established to extend medium and long-term loans to member co-operatives. In addition, farmers' associations were also formed and were operating alongside the rural co-operatives societies. This however, had eventually led to some duplication of functions and undue competition. As a result, a more integrated approach in rural development was soon adopted and the rural credit institutions were consequently reorganised. Thus in 1973 the Farmers' Organisation Authority (FOA) was established mainly to co-ordinate the activities of the agro-based co-operative societies, the farmers' associations and also the public authorities and enterprises engaged in the financing and promoting of agricultural development specifically for the purchase of farm machinery, equipment and also off-farm activities in addition to supplying fertilizers, agrochemicals and other planning materials under its subsidy programmes. The major functions of the FOA were the provision of credit and subsidies to farmers' organisations under its supervision especially for crop production financing, purchase of farm equipment and development of infrastructural facilities. Besides the rural credit institutions, the Federal Land Development Authority (FELDA) was also actively involved in agricultural financing and had extended a significant amount of credit to this sector. Felda, established in 1965 concentrated mainly on opening new land development schemes, where intensive cultivation through intercropping and livestock rearing was carried out Thus under the land development and settlement programme, the settlers were provided with the opportunity to resettle in planned and settlement projects which provide the basis for better farming, business opportunities, better living conditions and self-sufficiency. To complement Felda's role, the Agricultural Bank of Malaysia (ABM) was established in 1969 to promote sound agricultural development and its related activities through the mobilisation of the rural savings and the provision of credit facilities. The Government since 1981, had been giving grants to ABM for relending as "welfare loans" at interest rates of 0-2 per cent per annum with the aim of alleviating poverty and restructuring of society particularly the agro-based community. ABM's main task was to provide credit facilities to farmers and fishermen, in addition to a variety of loan programmes which catered to the needs of all levels of production, processing and marketing activities of the agricultural sector. Its lending programmes were formulated to provide the broadest coverage to all aspects of agricultural activities. ABM's credit programmes were categorised according to commodities ranging from padi credit to rubber credit. These credits were based on the type of activity the borrower was involved in, whether in production, processing or marketing of a particular commodity. Apart from its own credit programmes, ABM also worked closely with other government agencies to implement their projects in an integrated manner. One such example was the Special Integrated Agricultural Loan Programme (SPKP) which the bank was responsible for managing special allocations to finance certain integrated projects. Born of a joint effort by various government agencies such as the Economic Planning Unit, Treasury, Agricultural Bank and the Agriculture Ministry, the SPKP started off with an allocation of $250 million (subsequently revised to $115 million) for the Fifth Malaysia Plan period. Under the Sixth Malaysia Plan, $80 million had been allocated. The ABM as the administering agency, was to issue the loans at four per cent interest with the capital provided by the Treasury. Response to the scheme had been favourable where to date, almost $100 million had been approved, of which $68 million had been disbursed. Under the SPKP, the Farmers Organisation Authority, the Department of Agriculture, the Fishery Development Board and the Fisheries

Department would identify their own projects or 'loanees' and each of them would then submit their recommendations to the bank based on their priorities. ABM, being at the core of agricultural development in the country, will continue to develop and promote the agricultural sector by expanding and intensifying its activities as well as developing new enterprises. In so doing, it also aims to turn local farmers into modern and commercially-oriented entrepreneurs. Since 1986, the bank had identified 16 commodities for which tailored lending programmes were introduced, including the Padi Production Scheme, The Tobacco Production and Marketing Scheme, The Equipment Loan Scheme, The Tobacco Production and Marketing Scheme, the Equipment Loan Scheme, The Pineapple Credit Scheme, Other Crops Loan Facilities, Livestock Loan, The Fishery Loan Scheme, The Agribusiness Loan Scheme, Contract Loan Facilities, Land Purchase Loan Scheme' Estate Development Loans, The Forestry Loan Scheme, and Redemption and Development Scheme for Malay Land.

As noted in Table 8.1, growth in long-term financing for both the agricultural and manufacturing sectors have been favourable by registering double-digit average growth of 12.7 per cent and 20.3 per cent respectively during 1981-1990. Another observation was that the average growth rates of long-term financing for both the agricultural and manufacturing sectors (12.7 per cent and 20.3 per cent respectively) was higher than their total financing average growth rates at 11.9 per cent and 15.7 per cent respectively during the same period. Taking the share of agricultural sector long-term financing over the aggregate long-term financing for all sectors, it was noted that the proportion had been on the declining trend each year from as high as 22.8 per cent in 1980 to a low of 14 per cent in 1990. In contrast, a different trend was reflected by the manufacturing sector, where the proportion of long-term financing of this sector to the aggregate long-term financing had been increasing steadily from 11.5 per cent in 1980 to 13 per cent in 1990 (except for the years 1984 through 1987), thus reflecting a notable shift in the emphasis of long-term financing by the credit institutions from agriculture to the manufacturing sector as a result of rapid industrialisation programmes. This had also resulted in channelling and adjusting its credit allocation in response to this development in the banking system. Likewise the ACIs had also become more selective in their loans allocation to avoid large bad debts amount.

As at the end of 1990, the share of agriculture sector's total financing to aggregate financing of all sectors was 9.5 per cent, which was

Table 8.1

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS
(Outstanding Balance)

(Million Ringgit)

Year-end	Long-term Financing 1/			Total Financing			A/D	B/E	C/F
	Agricultural Sector (A)	Manufacturing Sector (B)	All Sectors (C)	Agricultural Sector 2/ (D)	Manufacturing Sector 3/ (E)	All Sectors (F)			
1980	2,859.4 (22.8)	1,440.3 (11.5)	12,552	3,952.3 (13.5)	5,757.8 (19.6)	29,367	72.3	25.0	42.7
1981	3,467.9 (21.2)	1,969.3 (12.0)	16,388	4,614.4 (12.6)	7,272.8 (20.0)	36,528	75.2	27.1	44.9
1982	4,527.7 (19.7)	2,301.0 (10.0)	22,983	5,891.0 (13.6)	7,911.5 (18.3)	43,340	76.9	29.1	53.0
1983	5,221.1 (20.3)	2,996.4 (11.7)	25,719	6,779.3 (12.5)	9,694.6 (17.9)	54,047	77.0	30.9	47.6
1984	5,918.8 (17.4)	3,053.4 (9.0)	33,976	7,532.8 (11.6)	9,999.9 (15.5)	64,675	78.6	30.5	52.5
1985	6,312.0 (16.2)	3,181.7 (8.2)	39,026	8,054.4 (11.0)	10,751.4 (14.6)	73,391	78.4	29.6	53.2
1986	6,700.9 (15.7)	3,346.1 (7.9)	42,595	8,562.0 (11.0)	11,137.5 (14.3)	77,858	78.3	30.0	54.7
1987	6,993.9 (15.4)	3,581.0 (7.9)	45,298	8,676.4 (11.1)	11,103.6 (14.2)	77,947	80.6	32.3	58.1
1988	7,479.5 (14.6)	4,749.3 (9.3)	51,264	9,230.0 (10.8)	13,584.5 (15.9)	85,226	81.0	35.0	60.2
1989	8,022.5 (15.1)	6,227.8 (11.7)	53,154	10,155.0 (10.1)	17,036.5 (16.9)	100,820	79.0	36.6	52.7
1990	9,192.9 (14.0)	8,523.9 (13.0)	65,804	11,700.5 (9.5)	22,444.6 (18.2)	123,343	78.6	38.0	53.4
Average annual rate of increase of 1981-1990	12.7	20.3	18.6	11.9	15.7	15.7	-	-	-

1 Refers to loans with maturities of above one year.
2 Refers to total loans extended by the banking system and the agricultural credit institutions.
3 Refers to total loans extended by the banking system and the Industrial Finance Institutions only.
4 Figures in parentheses represent the share of that sector to the overall sector total.

relatively lower than its long-term financing share to aggregate long-term financing of all sectors (14 per cent). Generally it can be concluded that long-term financing made up the bulk of agriculture sector's total financing averaging at 78 per cent during the 1980-1990 period. A somewhat different trend was noted for the manufacturing sector, where its total financing share to the aggregate financing of all sectors (18.2 per cent) outpaced its long-term financing share of aggregate long-term financing of all sectors (13 per cent) as at the end of 1990. This briefly showed that for the manufacturing sector, long-term financing was not the main norm of financing, since the sector's long-term financing only accounted for an average of 30 per cent of total financing of the manufacturing sector during the 1980-1990 period. These different trends outlined above clearly reflected the different nature of the manufacturing and agriculture sectors and their financing structure. In the case of the agricultural sector, the long gestation period involved in reaping the agriculture produce (which is particularly so in the case of rubber and palm oil) had naturally resulted in a higher proportion of long-term financing. On the other hand, long-term financing was not a popular norm among manufacturers since most entrepreneurs in this sector tend to source their funds from internal funds such as from profits, shareholders' funds and inter-company loans. This tradition of sourcing funds internally was further confirmed by the findings of the Bank Negara Malaysia 1990 Survey of Private Investment which indicated that a high percentage of investment undertaken by the manufacturing firms being surveyed were financed through internally-generated funds (71 per cent in 1987; 52 per cent in 1990). In addition, the banking system which is traditionally the main supplier of credits to the productive sectors, despite encouragement and moral suasion from the Central Bank to give more loans to the manufacturing and agricultural sectors, prefered to channel credits to the trading, real estate and property sectors.

To further analyze the significance of long-term financing for the two sectors, Table 8.2 has been tabulated to measure the proportionate share of the long-term financing of the manufacturing and agricultural sectors as a group to the overall GDP growth, to their total exports and value-added. The importance of the long-term financing of these sectors to total GDP growth was reflected in the share which had increased steadily during the period under review and peaked to 22.3 per cent in 1990. Similar trend of growth was also observed for the long-term financing share of the agricultural and manufacturing sectors to

Table 8.2

RATIO OF LONG-TERM FINANCING FOR THE MANUFACTURING AND AGRICULTURAL SECTORS TO GDP, TOTAL EXPORTS AND VALUE ADDED

(Million Ringgit)

Year-end	Aggregate Long-term Financing for the Two Sectors (A)	GDP (B)	Total Exports 1/ (C)	Value Added 1/ (D)	A/B	A/C	A/D
						%	
1980	4,299.7	44,511.0	18,668.4	18,932.0	9.7	23.0	22.7
1981	5,437.2	47,601.0	17,636.7	19,839.0	11.4	30.8	27.4
1982	,828.8	50,445.0	18,593.6	21,066.0	13.5	36.7	32.4
1983	8,217.5	53,583.0	21,943.6	21,731.0	15.3	37.4	37.8
1984	8,972.2	57,742.0	26,506.5	23,335.0	15.5	33.8	38.4
1985	9,493.7	57,093.0	24,899.1	23,117.0	16.6	38.1	41.1
1986	10,047.0	57,751.0	27,278.9	24,459.0	17.4	36.8	41.1
1987	10,574.9	60,863.0	35,678.2	26,950.0	17.4	29.6	39.2
1988	12,228.8	66,303.0	45,637.9	30,084.0	18.4	26.8	40.6
1989	14,250.3	72,435.0	55,835.6	33,211.0	19.7	25.5	42.9
1990	17,716.8	79,551.0	64,834.0	36,161.0	22.3	27.3	49.0

1 Refers to the manufacturing and agricultural sectors only.

total exports which fluctuated during the period under review from the lowest level of 23 per cent in 1980 to the peak of 38.1 per cent in 1985 and gradually slackened to 27.3 per cent in 1990.

1.1.2 Contribution of the Manufacturing and Agricultural Sectors in Promoting Employment and Exports

To measure the contribution of the agricultural and manufacturing sectors to total employment, each sector's share to total employment and their growth rates were tabulated in Table 8.3. Using this analysis, it is found that the share of the agricultural sector's employment to total employment had declined from 37.2 per cent as at end December 1980 to 27.8 per cent as at end December 1990. On the contrary, the share of the manufacturing sector depicted a more stable picture ranging between 15 per cent to 19.5 per cent, which precisely was in line with the growing importance of this sector to the overall economic growth. It was also observed that the growth of the agricultural sector's employment during 1981-1990 was very modest averaging at less than one percentage point (0.2 per cent), against a higher average growth of 5.7 per cent for the manufacturing sector. The growth in manufacturing employment also exceeded that of the total national employment (3.3 per cent). By segregating average growth rate of total employment of

Table 8.3

CONTRIBUTION OF AGRICULTURAL AND MANUFACTURING SECTORS TO EMPLOYMENT 1/

(Per Cent Share)

	Share to Total Employment		Rate of Increase in Employment 2/							
Year-end	Agricultural Sector	Manufacturing Sector	Total National Employment	Agricultural Sector		Manufacturing Sector		Other Sector	
1980	37.2	15.5							
1981	35.2	15.6	4.7	-1.0	(-0.4)	5.3	(0.8)	8.8	(4.3)
1982	33.0	15.6	3.7	-3.0	(-1.1)	3.5	(0.5)	8.5	(4.3)
1983	31.5	15.5	3.6	-1.1	(-0.3)	2.9	(0.4)	6.6	(3.5)
1984	31.0	15.8	2.5	0.8	(0.2)	4.5	(0.7)	3.0	(1.6)
1985	31.3	15.2	1.2	2.1	(0.7)	-2.7	(-0.4)	1.6	(0.9)
1986	31.7	15.1	1.5	2.7	(0.9)	0.7	(0.1)	1.0	(0.5)
1987	31.9	15.7	3.1	3.8	(1.2)	7.0	(1.1)	1.5	(0.8)
1988	31.3	16.6	3.6	1.7	(0.5)	10.0	(1.7)	2.7	(1.4)
1989	29.1	18.4	4.7	-3.0	(-0.9)	15.6	(2.9)	5.1	(2.7)
1990	27.8	19.5	4.4	-0.7	(-0.2)	10.2	(2.0)	4.9	(2.6)
Average during 1981-1990	-	-	3.3	0.2	(0.1)	5.7	(1.0)	4.4	(2.3)

1 Employment is as at end December each year.

2 Figures in parentheses represent sectoral contributions to the overall rate of increase in employment.

3.3 per cent during 1981-1990 into agriculture, manufacturing and other sectors, it was noted that the manufacturing and other sectors contributed 1 per cent and 2.3 per cent respectively, while that of the agriculture sector was almost negligible at 0.1 per cent.

In addition to the two sector's contributions to the overall employment growth, observations were also made for their contribution to total exports (Table 8.4). The main feature of Table 8.4 reflected mainly the distinct shift in importance between the two sectors, where the share of agricultural exports to total exports was on a declining trend during the 1980-1990 period, the share of the manufacturing sector recorded a significant annual growth of 58.8 per cent in 1990 from a modest share of 22.4 per cent in 1980. It was also noted that the share of the manufacturing sector to total exports accelerated sharply to 43.5 per cent in 1986 after the recession year of 1985 and this uptrend was sustained thereafter. In contrast, the significance of the agricultural

Table 8.4

CONTRIBUTION OF AGRICULTURAL AND MANUFACTURING SECTORS TO EXPORTS 1/
(Annual Performance Basis)

(Per Cent)

	Share to Total Exports		Rate of Increase in Exports 2/							
Year-end	**Agricultural Sector**	**Manufacturing Sector**	**Total National Employment**	**Agricultural Sector**		**Manufacturing Sector**		**Other Sectors**	
1980	43.7	22.4							
1981	41.5	23.5	-3.7	-8.9	(3.7)	1.0	(0.2)	-0.7	(-0.2)
1982	39.4	26.7	4.2	-1.5	(-0.6)	17.7	(4.7)	0.4	(0.1)
1983	37.2	29.7	17.1	10.0	(3.7)	29.8	(8.8)	13.8	(4.6)
1984	36.4	32.3	18.3	15.1	(5.5)	27.9	(9.0)	12.1	(3.8)
1985	32.7	32.8	-1.0	-11.5	(-3.8)	...	...	8.0	(2.8)
1986	33.7	43.5	-	-4.0	(-1.3)	23.1	(10.0)	-38.4	(-8.8)
1987	33.9	45.0	28.2	28.6	(9.7)	32.5	(14.6)	18.4	(3.9)
1988	34.0	48.6	23.4	22.5	(7.7)	32.0	(15.6)	0.6	(0.1)
1989	28.4	53.9	24.6	2.4	(0.7)	36.2	(19.5)	24.8	(4.4)
1990	22.2	58.8	19.4	-6.9	(-1.6)	28.0	(16.5)	24.1	(4.5)
Average during 1981-1990	-	-	13.0	4.6	(1.6)	22.8	(9.9)	6.3	(1.5)

1 Total exports refer to agriculture, mining and manufactures exports, with agriculture products (excluding minerals and other exports) being regarded as agriculture exports and all manufactured items as exports of the manufacturing sector.
2 Figures in parentheses represent sectoral contributions to the overall rate.

exports to total exports lost its momentum in 1985 declining from 36.4 per cent in 1984 to 32.7 per cent in 1985. Although its share picked up during the 1986-1988 period, it failed to sustain its momentum and its share to total exports declined to 22.2 per cent in 1990. The rate of increase in exports of the agricultural and manufacturing sectors averaged at 4.6 per cent and 22.8 per cent respectively during 1981-1990.

In a further analysis, when the average annual growth rate of total exports (13 per cent) during 1981-1990 were divided into the agriculture, manufacturing and other sectors to measure the importance of each sector, it was found that the contribution of the manufacturing sector to overall exports lead the other sectors with a 9.9 per cent share, against a lower share of 1.6 per cent and 1.5 per cent respectively for the agricultural sector and other sector.

1.1.3 Long-term Financing for the Manufacturing and Agriculture Sectors by Products

In the analysis of long-term financing to the manufacturing sector by product, a mixed trend was observed (Refer to Table 8.5). The resource-based industries (in this context, the wood-based, rubber products and chemicals and chemicals products industries) and the construction-related industries (the non-metallic mineral products and basic metals and metal products) accounted for a larger share of the long-term financing, with a share of 24 per cent and 23.6 per cent respectively at the end of 1990. While the share of both the resource-based and construction-related sectors remained significant during the period under review (1980-1990), each averaging at 23 per cent, a declining trend in the shares of several industries was observed, namely, the food, beverages and the tobacco products industry which was evident since 1986 falling from 10 per cent to 5 per cent in 1990; the textiles and wearing apparel industry from 10.3 per cent in 1980 to 6.2 per cent in 1990; and the transport equipment industry from 10.2 per cent in 1980 to 4.1 per cent in 1990. The declining share of long-term financing for the transport equipment industry (specifically cars assembly) was partly due to the major joint-venture project undertaken by several companies in this sector. The bulk of financing and investment for this venture were sourced both from abroad as well as from the domestic funds (including the banking system). Against the declining trend in the shares of long-term financing encountered by industries listed above, several industries particularly those producing electronics and electrical

Table 8.5

LONG-TERM FINANCING FOR THE MANUFACTURING SECTOR BY PRODUCT

(Per Cent of Total)

Year	Food, Beverages and Tobacco	Textiles and Wearing Apparel	Wood and Wood Products	Printing and Publishing	Chemical and Chemical Products	Rubber Products	Non-Metallic Mineral Products	Basic Metals and Metal Products	Electronics and Electrical Products	Transport Equipment	Others	TOTAL
1980	9.7	10.3	11.2	4.7	6.6	3.2	8.7	8.6	1.9	10.2	24.9	100.0
1981	10.0	8.6	12.7	5.1	5.3	4.0	9.0	9.5	2.4	10.8	22.6	100.0
1982	10.4	7.8	13.3	5.6	6.5	4.1	9.3	12.7	2.9	7.2	20.2	100.0
1983	10.7	7.9	13.0	5.9	6.4	4.1	10.5	12.6	2.4	6.7	19.8	100.0
1984	11.8	5.9	13.0	7.1	7.0	3.3	12.7	10.2	3.2	8.7	17.1	100.0
1985	10.8	5.4	11.0	6.8	8.4	3.2	14.3	11.4	3.7	9.1	15.9	100.0
1986	10.0	5.7	11.8	6.9	7.1	3.2	14.4	11.5	4.5	7.9	17.0	100.0
1987	9.4	5.3	11.7	6.7	6.1	4.0	13.5	11.2	8.3	6.4	17.4	100.0
1988	7.8	4.9	10.5	5.7	6.6	7.9	11.3	13.3	9.4	5.0	17.6	100.0
1989	6.3	4.9	10.5	5.8	7.3	9.5	11.7	13.2	10.2	4.0	16.6	100.0
1990	5.1	6.2	10.0	8.3	7.1	6.9	9.5	14.1	11.1	4.1	17.6	100.0

products and printing and publication accounted for a higher share. The printing and publication industry for instance, had succeeded in almost doubling its share of long-term financing from 4.7 per cent in 1980 to 8.3 per cent in 1990. However, a more significant increase was noted in the electronics and electrical products industry whose share increased from a low of 1.9 per cent in 1980 to as high as 11.1 per cent in 1990. Classification of major manufactured goods for both the export and import group during the 1980-1990 period is tabulated in Table 8.6. Generally, it can be concluded that the non-resource based items namely electronics, electrical goods, and textiles and wearing apparel were the largest contributor of foreign earnings to Malaysia, hence endorsing the narrow industrial base of the manufacturing sector.

A similar table (Table 8.7) on long-term financing for the agriculture sector by products was tabulated to analyze the trend in long-term financing for this sector. It was observed that major agricultural commodities, namely, rubber, palm oil and cocoa were predominant in their shares of long-term financing. This group of commodities accounted for almost three-quarter (73.9 per cent) of total long-term financing in 1980 and their shares were consistently high during 1980-1990, so much so that by 1990 their shares almost reached the 80 per cent level. The predominance of these commodities was partly contributed by the fact that their loans maturity period ranged from between 3 to 6 years and mainly involved the plantation sector. On the other hand, the declining importance of some minor commodities, namely, padi, coconut and tobacco was reflected in their lower contribution to the overall agricultural growth and further translated into lower shares of the agricultural sector's long-term financing.

1.1.4 Other Institutions Involved in the Financing and Development of the Agriculture and Manufacturing Sectors

In this section, greater details on the roles of other financial intermediaries and schemes involved in the financing of the agricultural and manufacturing sectors would be highlighted.

The ASEAN-Japan Development Fund (AJDF) was launched in January 1989 with the objective of providing concessional loans to small and medium-scale businesses in the manufacturing, agricultural and tourism sectors. Total AJDF allocated to Malaysia was M$895 million and this amount was jointly funded by the Overseas Economic Co-operation Fund (OECF: M$687 million) and the Export-Import Bank of Japan (EXIM Bank: M$208 million). The AJDF loan was chanelled through four participating financial institutions namely, the Industrial Bank of Malaysia (allocation: M$235 million), the Malaysian Industrial Development Finance (M$270 million), the Malaysian Industrial Development Finance (M$270 million), the Development Bank of Malaysia and the Agricultural Bank of Malaysia at M$195 million each. Loans under the AJDF scheme which was funded by the OECF carried an interest rate of 6.5 per cent per annum, while interest rate for loans funded by the EXIM Bank was 7.8 per cent per annum. The maximum loan repayment period for the AJDF loan was 15 years. Under the AJDF scheme, financing for working capital purposes, acquisition of shares, purchase of lands and take-overs of existing productive capacity were not allowed.

Table 8.6

MAIN EXPORT AND IMPORT COMMODITIES

(Value and Per Cent Share)

Year	Main Export Commodities	Xs Value (M$ million)	Total Xs (M$ million)	% share	Main Import Commodities	M Value (M$ million)	Total M (M$ million)	% share
1980	Electronics, electrical appliances and machinery, textiles, apparel and footwear, food and wood products	4,784	6,319	76	Materials for manufacturing, machinery, metal products, transport equipment and food	13,174	23,451	56
1981	Electronics, electrical appliances and machinery, textiles, apparel and footwear, food and wood products	5,150	6,384	81	Materials for manufacturing, machinery, metal products, transport equipment and food	14,635	26,604	55
1982	Electronics, electrical appliances and machinery, textiles, apparel and footwear and food	5,546	7,512	74	Materials for manufacturing, machinery, metal products, crude oil and petroleum products and food	18,656	29,023	64
1983	Electronics, electrical appliances and machinery, textiles, apparel and footwear, petroleum and chemical products	7,304	9,749	75	Materials for manufacturing, machinery, metal products, petroleum products and food	17,968	30,795	58
1984	Electronics, electrical appliances and machinery, textiles, apparel and footwear, petroleum and chemical products	9,460	12,467	76	Materials for manufacturing, machinery, metal products and food	17,901	32,926	54
1985	Electronics, electrical appliances and machinery, textiles, apparel and footwear, petroleum and chemical products	9,433	12,471	76	Materials for manufacturing, machinery, metal products and food	16,179	30,438	53
1986	Electronics, electrical appliances and machinery, textiles, apparel and footwear, petroleum and chemical products	11,532	15,352	75	Materials for manufacturing, machinery, metal products, transport equipment and food	17,138	27,921	61
1987	Electronics, electrical appliances and machinery, textiles, apparel and footwear	13,031	20,344	64	Materials for manufacturing, machinery, metal products and food	18,486	31,934	58
1988	Electronics, electrical appliances and machinery, textiles, apparel and footwear	17,529	26,850	65	Materials for manufacturing, machinery, metal products and food	26,062	43,293	60
1989	Electronics, electrical appliances and machinery, textiles, apparel and footwear	23,895	36,572	65	Materials for manufacturing, machinery, metal products, transport equipment and food	39423	60858	65
1990	Electronics, electrical appliances and machinery, textiles, apparel and footwear	30,410	46,841	65	Materials for manufacturing, machinery, metal products, transport equipment and food	50772	79120	64

Table 8.7

LONG-TERM FINANCING FOR THE AGRICULTURE SECTOR BY PRODUCT

(Per Cent of Total)

Year	Rubber	Padi	Palm Oil	Coconut	Cocoa	Tobacco	Others	TOTAL
1980	16.0	7.6	43.4	0.5	14.5	0.8	17.2	100.0
1981	12.1	6.8	44.3	0.6	22.9	0.7	12.6	100.0
1982	10.0	6.3	42.8	0.9	26.3	0.3	13.4	100.0
1983	10.8	5.5	41.3	1.1	28.5	0.4	12.4	100.0
1984	12.0	5.9	38.5	0.8	29.8	0.5	12.5	100.0
1985	12.6	3.7	38.8	0.6	30.5	0.4	13.4	100.0
1986	14.2	5.2	33.9	0.4	29.9	1.2	15.2	100.0
1987	15.6	5.3	36.1	0.5	27.8	1.1	13.6	100.0
1988	11.8	5.2	39.5	0.5	26.6	1.1	15.3	100.0
1989	14.5	5.8	38.4	0.5	24.9	0.8	15.1	100.0
1990	21.0	5.2	32.1	0.2	26.4	0.9	14.2	100.0

The Credit Guarantee Corporation (CGC) which was established in 1973, does not give loans but rather provides guarantees on loans made by the commercial banks to small-scale enterprises.

The Federal Land Consolidation and Rehabilitation Authority (FELCRA) concentrated on development and settlement programmes aimed at producing viable farming communities. FELCRA provided credit for the rehabilitation of projects on Government land and also for the development of new land that was deemed suitable for agriculture in the remote and interior areas so as to increase agricultural production and the income of farmers.

Credit for the agriculture sector was also provided by the Rubber Industry Smallholders Authority (RISDA) for replanting, intercropping, redemption of land titles, consumption during the period of crop immaturity and other agricultural activities. In addition, the National Tobacco Board provided fertilizer credit to curers of tobacco leaves and also to farmers in the estates of Kelantan, Terengganu and other tobacco industry areas, while the Federal Agricultural Marketing Authority (FAMA) provided production credit especially for crops such as cocoa, coffee, pepper and vegetables. FAMA was primarily concerned with the systematic marketing of rural agricultural products.

In 1985, when the banking system was experiencing tight liquidity and the cost of borrowing was high, the Central Bank set up the New Investment Fund (NIF) to provide credits at reasonable cost for new investments in selected sectors namely, the manufacturing, mining, tourism and agricultural sectors. The NIF facility had a total allocation of \$1.7 billion and in view of the improved liquidity situation this fund was not extended upon its full utilisation. As at end December 1990, a total of \$1.4 billion was approved of which the manufacturing sector accounted for the bulk or 72 per cent of total loans; agriculture, 19 per cent; tourism, 6 per cent and the remaining 3 per cent to the cash crop sector. Of significance was that under the NIF scheme, the bulk of the fund was disbursed by the participating commercial banks (76 per cent) followed by the merchant banks and development banks (15 per cent and 9 per cent respectively).

The Government of Malaysia allocated a \$50 million grant known as the Industrial Technical Assistance Fund (ITAF) to promote the growth and viability of small and medium-sized industries (SMIs) in 1990. To modernise the SMIs as a whole, four schemes have been introduced under the ITAF, namely, activities to carry out feasibility studies; product development and design; to improve the quality and productivity of their goods and to upgrade their marketing strategies. ITAF 1 or the feasibility studies scheme would enable the SMIs to commission consultants to carry out feasibility studies on the modernisation of their factories and ways to increase output and quality. A total of \$5 million has been allocated for this scheme and it is to be managed by the Development Bank of Malaysia. ITAF 2 or the product development and design scheme was allocated with a \$20 million fund, to upgrade local technology know-how. This scheme will be administered by the Standard and Industrial Research Institute of Malaysia (SIRIM). SIRIM will also manage the quality and productivity improvement scheme (ITAF 3) to upgrade and improve the quality of SMIs products in order to meet the requirement of the national certification schemes operated by SIRIM. Finally, ITAF 4 or known as the marketing oriented study scheme was established to help the SMIs to venture into the export market and improve their marketing management. In this respect, MEXPO (or the Malaysian Exports Trade Centre) was responsible for managing this scheme which had an allocation of $5 million. On the whole, grant under the ITAF scheme would be provided on a dollar for dollar basis and the $50 million fund should be fully disbursed by 1995. To date, about $4 million had been disbursed in the form of grants to 87 small and medium-scale entrepreneurs.

In Malaysia, some form of leasing was first conducted by a finance company in 1965. It was only nine years later, in 1974, that the first independent leasing company, United Orient Leasing (UOL) started its operations. Leasing companies in Malaysia were mainly engaged in equipment lending activities and were registered under the Companies Act, 1965. Initially, there was no specific law or regulation in Malaysia governing the leasing industry. However, with the introduction of BAFIA in 1989, the leasing companies were under the purview of the Act. Growth in leasing activities in terms of the number of companies in this industry was slow until the licensed financial institutions entered the market in 1979. However, the Central Bank does not allow the commercial banks to engage in leasing activities directly. Leasing activities by banks were normally conducted through their wholly-owned subsidiary or joint-venture arrangements with foreign and other local partners. Unlike the commercial banks, most finance companies and merchant banks were directly engaged in leasing activities. Entry into leasing operations grew more rapidly during the period 1980-1983, partly because of the tax incentives given to this industry in the form of accelerated depreciation allowance (ADA) introduced in 1981. However, a number of smaller and weaker companies left the industry after having suffered heavily from the recession of 1985-1986. Consequently, the number of companies actively offering leasing facilities in Malaysia which had increased from two in 1974 to more than 250 in 1985 was reduced to 150 in 1988. Due to insufficient data, tabulation on the amount of leasing contracts can only be made for the years 1989 and 1990 (Table 8.8). Reflecting the traditional activities of the leasing companies, that is, in equipment lending activities, the agriculture machinery and equipment and the industrial and construction equipment dominated the total leasing contracts in 1989 and 1990 at 50.5 per cent and 43.6 per cent respectively. On the whole it can be concluded that the popularity of leasing in this country was simply because it became an additional financial tool for the business community. It provided medium-term financing for the acquisition of capital assets, a service which may not be readily available from other financial institutions.

Table 8.8

AMOUNT OF LEASING CONTRACTS 1/

(M$'000)

	1989		1990	
	Amount	**Per Cent of Total**	**Amount**	**Per Cent of Total**
Agriculture machinery and equipment	240.5	21.0	258.6	17.8
Industrial and construction equipment	337.4	29.5	374.8	25.8
Motor vehicles	126.7	11.1	195.2	13.4
Consumer durables	17.4	1.5	7.8	0.5
Others	423.0	36.9	619.1	42.5
Total	1,145.0	100.0	1,455.5	100.0

1 By the banking system only.

1.2 Sources of Long-Term Financing

It can be observed from Tables 8.9, 8.9a and 8.9b that the specialised financial institutions namely, the Industrial Finance Institutions (IFIs) and the Agricultural Credit Institutions (ACIs) which were set up to cater for the medium to long-term financing of the agriculture and manufacturing sectors remained the primary source of long-term credit to these sectors. For the agricultural sector, the ACIs continued to play the lead role in the provision of medium and long-term credit as it accounted for more than half of the long-term credit of this sector (i.e.

Table 8.9

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS BY INSTITUTIONS 1/
(As at end of 1980)

(Million Ringgit)

Institutions	Agricultural Sector			Manufacturing Sector			All Sectors	
	Value		% of Total	Value		% of Total	Value	% of Total
Commercial banks	673.4	(9.8)	23.6	958.3	(13.9)	66.5	6,881.2	54.8
Finance companies	380.3	(11.8)	13.3	167.1	(5.2)	11.6	3,235.7	25.8
Industrial finance institutions	-	-		314.9	(62.8)	21.9	501.2	4.0
Agriculture credit institutions	1,805.7	(93.4)	63.1	-	-		1,933.4	15.4
Total	2,859.4	(22.8)	100.0	1,440.3	(11.5)	100.0	12,551.5	100.0

Table 8.9a
(As at end of 1985)

Institutions	Agricultural Sector			Manufacturing Sector			All Sectors	
	Value		% of Total	Value		% of Total	Value	% of Total
Commercial banks	1,421.6	(6.5)	22.5	1,909.3	(8.8)	60.0	21,809.9	55.9
Finance companies	643.7	(5.7)	10.2	575.4	(5.1)	18.1	11,236.5	28.8
Industrial finance institutions	-		-	697.0	(45.4)	21.9	1,535.2	3.9
Agriculture credit institutions	4,246.7	(95.5)	67.3	-		-	4,444.8	11.4
Total	6,312.0	(16.2)	100.0	3,181.7	(8.2)	100.0	39,026.4	100.0

Table 8.9b
(As at end of 1990)

Institutions	Agricultural Sector			Manufacturing Sector			All Sectors	
	Value		% of Total	Value		% of Total	Value	% of Total
Commercial banks	2,158.0	(7.2)	23.5	6,292.2	(21.0)	73.8	29,964.5	45.5
Finance companies	1,002.5	(3.8)	10.9	1,315.5	(4.9)	15.4	26,681.7	40.5
Industrial finance institutions	-		-	916.2	(46.1)	10.8	1,988.3	3.0
Agriculture credit institutions	6,032.4	(84.1)	65.6	-		-	7,169.3	11.0
Total	9,192.9	(14.0)	100.0	8,523.9	(13.0)	100.0	65,803.8	100.0

1 Figures in parentheses represent sectoral shares to aggregate long-term financing by each institution.

1980: 63.1 per cent, 1985: 67.3 per cent and 1990: 65.6 per cent). This was followed by the commercial banks which accounted for almost a quarter of total long-term credit to the agricultural sector (1980: 23.6 per cent, 1985: 22.5 per cent and 1990: 23.5 per cent). The importance of the ACIs as the primary source of credit to the agricultural sector was generally due to the more favourable and flexible lending criteria of the institutions in the ACI group, in addition to more branches located nearby to the agricultural community. The ACIs were also committed to provide loans to this community since their major source of funds were from the Government. A somewhat different picture was observed for the manufacturing sector. The commercial banks especially, provided the bulk of long-term financing to this sector as evident from their large shares of 66.5 per cent in 1980, 60 per cent in 1985 and a record share of 73.8 per cent in 1990. On the other hand, the IFIs registered a declining share during the period under review, particularly in 1990 when they only accounted for about 11 per cent. The decline was partly due to the almost full utilisation of funds allocated to the IFIs. The significant increase in the commercial banks' share was in line with the rapid industrialisation drive which had resulted in commercial banks offering more medium and long-term credit to this most potential economic growth sector.

The principal source of funds of the IFIs, which is one of the major source of long-term financing institutions for the manufacturing sector consist mainly of borrowings and shareholders' fund (Table 8.10).

Table 8.10

SOURCES OF FUNDS OF THE INDUSTRIAL FINANCE INSTITUTIONS
(Million Ringgit)

	Year-end 1980 1/		Year-end 1985		Year-end 1990	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Shareholders' Equity	277.3	12.6	621.6	24.8	728.9	21.0
of which:						
Issued and paid-up capital	n.a	n.a	365.8	14.6	488.1	14.1
Share premium	n.a	n.a	5.5	0.2	5.6	0.1
Reserves	n.a	n.a	210.4	8.4	256.1	7.4
Unappropriated profits	n.a	n.a	39.9	1.6	(20.9)	(0.6)
Borrowings 2/	1,848.2	84.3	1,249.9	49.7	1,537.5	44.5
Others	67.7	3.1	641.6	25.5	1,192.5	34.5
Total	2,193.2	100.0	2,513.1	100.0	3,458.9	100.0

Note: Figures in bracket denotes negative value.
1 Breakdown for the shareholders' equity for this year is not available.
2 Includes deposits.

For the banking system, its primary source of funds were from deposits, particularly fixed deposits, which accounted for more than half of its overall deposits, 1980: 61.5 per cent; 1985: 65.8 per cent; 1990: 52.7 per cent (Table 8.11). Although fixed deposits remained significant and traditionally were the main component of the banking system's total deposits, an apparent decline in the importance of fixed deposits as a source of funds were noted - from 61.5 per cent in 1980 to 52.7 per cent in 1990. This decline reflected mainly the increasing importance of other financial instruments such as the Negotiable Certificate of Deposits (NCDs) and repurchase transactions (Repos). Through Repos, each bank is now able to utilise its marketable security holdings, such as bankers acceptances, trade bills and Malaysian Government Securities to raise short-term liquid funds. In 1980 for instance, the share of NCDs and Repos to total deposits were only 2.9 per cent and 1.5 per cent respectively and this had consistently rose to 6.8 per cent and 3.7 per cent in 1985 and 11.9 per cent and 8.1 per cent in 1990.

Table 8.11

SOURCES OF FUNDS OF THE BANKING SYSTEM

(Million Ringgit)

	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount	**% of total**	**Amount**	**% of total**	**Amount**	**% of total**
Deposits of which:	29,382.4	92.7	65,039.4	85.9	95,355.3	77.5
Fixed	19,503.3	61.5	49,832.7	65.8	64,864.8	52.7
Demand	5,326.3	16.8	7,950.4	10.5	15,024.8	12.2
Savings	4,552.8	14.4	7,256.3	9.6	15,465.7	12.6
NCDs issued	931.1	2.9	5,141.3	6.8	14,653.2	11.9
Repos	458.3	1.5	2,815.7	3.7	10,007.7	8.1
BAs	932.2	2.9	2,760.3	3.6	3,003.7	2.5
Total	31,704.0	100.0	75,756.7	100.0	123,019.9	100.0

Almost similar to the IFIs, the agricultural credit institutions' (ACI) main source of fund were from deposits, which accounted for almost half (47.4 per cent) in 1985 and increased further to 56 per cent in 1990 (Table 8.12). The principal source of funds of the ACI group were mainly from deposits, since the primary source of funds of its major contributors, namely, the Agricultural Bank of Malaysia and the Farmers' Organisation Association were from members' deposits. However, borrowing was less significant since it only accounted for almost a quarter or 23.9 per cent of the total source of funds in 1985 and 15.2 per cent in 1990.

Table 8.12

SOURCES OF FUNDS OF THE AGRICULTURAL CREDIT INSTITUTIONS 1/

(Million Ringgit)

	Year-end 1985		Year-end 1990	
	Amount	**% of Total**	**Amount**	**% of Total**
Paid-up capital and reserves	496.2	12.8	302.3	6.3
Borrowings	925.3	23.9	731.2	15.2
Deposits	1,831.4	47.4	2,700.3	56.0
Others	614.6	15.9	1,087.8	22.5
Total	3,867.5	100.0	4,821.6	100.0

1 Includes the Agricultural Bank, Bank Rakyat, Farmers' Organisations and Rural credit Co-operatives, and Sabah Development Bank. FELDA numbers were not included due to a lack of statistical data.

1.3 Lending Policies and Procedures

The use of direct credit control through the imposition of ceilings and the issuance of lending guidelines are some of the measures available to the Central Bank of Malaysia in regulating the volume and direction of credit of the banking system. The Central Bank of Malaysia issued annual lending guidelines every March to ensure that the priority sectors would continue to have ready access to credit at reasonable costs and to allow for adjustment of these guidelines in accordance with developments in the economy. As a result, the priority sectors for instance, would differ from year to year. Although the Central Bank issued general lending policies and guidelines, all institutions in the banking system were allowed to maintain their own internal lending guidelines, which however, must be operated within the ambit of Bank Negara Malaysia's lending policies and guidelines.

Different financial institutions adopt different long-term lending policies for both the agricultural and manufacturing sectors. The agricultural credit institutions (ACIs) and the banking system which were the main sources of long-term financing for the agricultural sector maintained their own general lending guidelines in addition to policies and procedures exclusive to each institution. The banking system which were under the supervision of the Central Bank, in addition to their own general and exclusive lending policies and procedures, were in a way 'guided' by the annual lending guidelines issued by the Central Bank. (Details as outlined in Table 8.13). Therefore, in general it can be concluded that the priority sectors' (including the manufacturing and agricultural sectors) loans and loan targets (either in absolute term and/ or percentage) as well as the compliance period (deadlines) were predetermined by the Central Bank. However, the banking system was free to determine ways and means in complying to these guidelines. In the event where any of the financial institutions failed to comply with the set guidelines, a certain amount of penalties would be imposed.

With regard to the specific guidelines to promote lending to finance agricultural activities, Bank Negara Malaysia in 1976 introduced a regulation requiring all commercial banks and lending institutions to lend a minimum of 10 per cent of net annual increase in loans and advances for agricultural food production for an initial period from October 1, 1976 to June 30, 1978. The lending period was subsequently extended to December 31, 1979 to give banks ample time to comply

Table 8.13

PRINCIPAL SUPPORT SYSTEM OF THE CENTRAL BANK OF MALAYSIA FOR LONG-TERM FINANCING
(As at end 1990)

Type of Facilities	Banks	Conditions	Term Year	Annual Interest Rates (%)
Loans to small-scale enterprises under the Principal Guarantee Scheme (PGS) of the Credit Guarantee Corporation (CGC).	All commercial banks	Banks are required to extend loans under the PGS of the CGC, the guarantee cover should amount to at least $200 million, of which 50 per cent must be the guarantee cover for loans to Bumiputera borrowers.	This is a two-year guideline where the deadline for compliance is March 31, 1991.	9 per cent or 1.75 percentage point above the BLR of the individual CBs whichever is lower.
Loans to the Bumiputera community.	All commercial banks and finance companies	These financial institutions are required to extend loans to Bumiputera community at a minimum of 20 per cent of the total loans outstanding as at December 31, 1989.	This requirement have to be complied by March 31, 1991.	
NIF loans provided by both the Central Bank and Treasury to help stimulate new fixed investments in the manufacturing, agriculture, tourism and mining sectors.	Most CBs, MBs and selected development finance institutions	This loans is extended to new ventures only in the selected economic sectors.	Maximum 5 years.	Minimum 5.0 per cent and maximum 7.75 per cent.

CBs : Commercial banks
MBs : Merchant banks

with this guideline. Hence, the percentage (originally 10 per cent) varies from year to year and finally has been adjusted to 6 per cent of total loans outstanding as at December 31, 1983 for the years 1984 and 1985. However, upon the introduction of the New Investment Fund (NIF) which offered the cash crop facility, this guideline was terminated in 1989.

As for the agricultural credit institutions (ACIs), the loan conditions and eligibility criteria used were generally quite standard. All loans were subjected to fixed terms and conditions to ensure that the projects were carried out successfully as well as to safeguard the bank's interest. Almost all agricultural loans were pegged with fixed maturity periods depending on the economic life of the projects, types of crops and commodities and also size of operations (be it smallholdings or estate). Specific repayment terms were provided for each loan depending on the income generated from the project and where appropriate, the borrower's ability to repay. In cases where funds were from external sources including funds from the Government or several international institutions (eg. ADB, AJDF or the World Bank loan scheme, etc.) the lending policies and procedures must be such that it is geared towards the achievement of each fund's objective. Furthermore, since these loans were soft loans in nature, the interest rates were normally pegged at preferential rates. To ensure that loans were not being abused, agricultural loans were disbursed in stages based on the progress of the project. Similar to other lending procedures, applications for agricultural loans (with the exception for some agricultural loans provided by the Agricultural Bank of Malaysia) must be backed by collaterals, which may be in the form of land grants or approved guarantors.

The criteria used in assessing long-term loans to the manufacturing sector were somewhat similar to that of the agriculture sector. With the exception of the Industrial Bank of Malaysia which catered especially for the shipyard and shiprepairs industry, all the other industrial finance institutions were involved primarily in lending to the industrial sector, particularly in manufacturing ventures and as such the conditions of the long-term loans varies slightly. Generally, loans application procedures for manufacturing ventures involved the following procedures. Prior to the submission of formal loan applications, most of the industrial finance institutions held discussions or consultations with their prospective borrowers, a practise which have proven to be useful in any loan application assessment. In any application for manufacturing loans (either long or short-term), applicants were required to provide basic/detailed information (on case-by-case basis), to prove that their projects were sound and the conduct of their operations would be under capable and competent management. Following this, each application would be considered strictly on its merit after careful study of the project including inspection of the premises, equipment and operations that have been carried out by the project appraisal staffs. As in the case for agriculture loans, collaterals were also required as guarantees in the application for manufacturing credit.

1.3.1 Credit Guarantee Corporation (CGC)

The Credit Guarantee Corporation or the CGC which was established in 1972 to provide guarantees to the commercial banks for loans extended to the small-scale enterprises could be considered as a special guarantee institution. Of the cumulative loans approved by the commercial banks under the CGC's guarantee scheme as at the end of 1985, only 8.8 per cent went to the agricultural sector against a higher share of 18.1 per cent as at the end of 1980. Consequently, its share dropped further in 1990 to 3.9 per cent. In the case of the manufacturing sector, although its share of the total loans guaranteed by the CGC was negligible, an encouraging development observed was that it had been on the rising trend over the years. As at the end of 1980, the manufacturing sector only accounted for about 8.8 per cent of total CGC's financing and this had subsequently increased to 9.4 per cent in 1985 and 13.2 per cent in 1990. The relatively small shares of both the agricultural and manufacturing sectors to the overall CGC guarantees (especially in 1990) was due to the bulk of its guarantees (83 per cent) being channelled to other sectors of the economy especially the sundry retail trade, building and construction as well as the wholesale and merchandising sectors. In a further breakdown of the financing of the manufacturing sector by the commercial banks under the CGC guarantees, it was noted that financing was distributed among various industries, particularly those producing building materials, food, beverages and tobacco, timber products and furniture, printing and publishing as well as textiles and clothing. In the case of the agricultural loans, guarantees were largely being absorbed by the livestock and poultry farming, padi cultivation and fish rearing sector. As at the end of 1990, the CGC in total administered three main guarantees schemes, namely, the Principal Guarantee Scheme (PGS), the Loan Fund for Hawkers and Petty Traders (LFHPT) and the Association Special Loan Scheme (ASLC). Although the General Guarantee Scheme (1973), the Special Loan Scheme (1981) and the Hawkers and Petty Traders Loan Scheme (1986) had ceased to operate, CGC, however, continued to monitor those loans granted under the respective schemes and those which were still subject to its guarantee. Specifically, the PGS provides guarantee cover to the commercial banks for credit facilities extended to eligible small-scale enterprises (SSEs) in the agricultural, commercial and industrial sectors for financing of their capital and operational requirements. In the case of the LFHPT (launched in March 1990), its primary objectives were aimed at encouraging and assisting the unemployed to start hawking

Table 8.14

CREDIT GUARANTEE CORPORATION: LENDING BY SECTORS

(Million Ringgit)

Secto	Year-end 1980		Year-end 1985		Year-end 1990	
	Amount Approved	% of Total	Amount Approved	% of Total	Amount Approved	% of Total
Agriculture	22.48	18.1	12.56	8.8	12.1	3.9
Manufacturing	10.88	8.8	13.46	9.4	41.2	13.2
Other sectors 1/	90.92	73.1	116.64	81.8	260.0	82.9
Total	124.28	100.0	142.66	100.0	313.3	100.0

1 Includes small business, mining and quarrying loans for the year 1990. However, data for 1980 and 1985 refer to general business which ncludes sundry retail trade, building and construction, wholesale trade, merchanting, and etc.

Source: CGC *Annual Report*, various issues.

and petty trading in addition to assisting the existing hawkers and petty traders to expand their business operations. Under this loan scheme (LFHPT), interest rate was pegged at 4 per cent per annum. On the other hand, the ASLS which was funded from a $20 million soft loan provided by the Central Bank, was interest-free and set up mainly to enable hawkers and petty traders' associations to play a more direct and effective role in helping their members to secure loans either to commence new business or expand their existing businesses. Loans provided to hawkers and petty traders under both schemes (ASLS and LFHPT) were disbursed through eight participating banks. While CGC managed the LFHPT, the ASLS was run by hawkers and petty traders' associations with guidance from CGC. Loans disbursed under the ASLS are 100 per cent guaranteed by the CGC and applicants do not have to provide collateral or guarantors. In 1990, the Government increased its loans allocation to assist the hawkers and petty traders to start or improve their business by $70 million bringing the total to $120 million. Of the $70 million allocated, $50 million was for the LFHPT, while the remaining $20 million was for the ASLS. As at end 1990, total loan approved under the LFHPT scheme totalled $6 million. Under the ASLS, a total of 2,111 hawkers and petty traders (or $4 million in absolute term) have benefited from the scheme. The CGC had also approved at total of 7,279 applications with loan limits of $392 million, of which the total guarantee cover was $145 million. Total loans guaranteed by the CGC under all its schemes (both new and old) as at December 31, 1990 totalled to 172,394 application, with an approved loan limits of $3,258 million.

1.3.2 Malaysian Export Credit Insurance Berhad (MECIB)

With the aim of complementing and supplementing the country's export promotion drive, the Malaysia Export Credit Insurance Berhad (MECIB) was established in 1977 as a joint venture company between the Malaysian Government and the private sector. MECIB's main objective was to provide an avenue for Malaysian exporters to obtain insurance cover against the risk of non-payment by their foreign buyers. In 1988, MECIB was wholly acquired by Bank Industri Malaysia Berhad. MECIB has a strong financial base and solid backing from the Malaysian Government (since Bank Industri is a Government-owned agency), and therefore was well equipped to support the export promotion drive in Malaysia. Facilities currently available from MECIB includes the comprehensive short-term financing facilities which cover the risk of non-payment due to buyer (commercial) or country (non-commercial) causes of loss for exports sold on credit not exceeding 6 months; specific policies which cover the risk of non-payment for exports of capital goods and/or services with lengthy manufacturing and/or payment periods, and high contract values; and the banker's export finance insurance policy (BEFIP) which covers or indemnifies banks and financial institutions which provide financing to exporters and indirect exporters.

II. The Role of Central Bank in Long-Term Financing for Manufacturing and Agricultural Sectors

2.1 Financing Facilities of the Central Bank

The role played by Bank Negara Malaysia in seeking to fulfill the long-term funding requirements of the manufacturing and agricultural industries was not direct, since it only formulate general policies and operational guidelines in 'influencing' the lending activities of financial institutions it supervised. The first attempt to channel credit directly to selected priority sectors of the economy was initiated in 1975, involving directives to all commercial banks and finance companies to channel a certain percentage of their loans to the priority sectors including the agriculture sector. Since then, these guidelines have been subjected to annual reviews which include guidelines requiring the commercial banks and finance companies to lend to priority sectors, namely, the Bumiputra community, agricultural food production and small-scale enterprises. These guidelines (directives) had been progressively reviewed, for instance in line with the latest development in the economy to include only lending to the Bumiputra community and to loan under the Principal Guarantee Scheme (PGS) of the CGC in 1990. Another measure taken by the Central Bank to stimulate banks to provide credit to the agricultural sector was to encourage the expansion of the banks network into the rural areas and providing discounting facilities for agriculture bill.

The Government together with Bank Negara Malaysia also established several funds for the financing of selected sectors of the economy. Among the first to be established was the New Investment Fund (NIF), set up in 1985 with an initial allocation of $1 billion. The fund was further expanded bringing its total amount to $1.7 billion (of which $700 million was funded by Bank Negara Malaysia and the remaining $1 billion by the Treasury). The NIF Scheme has since met its objective of helping to push new investment at a time of tight liquidity and high interest rates. In view of the improved liquidity situation during 1987 as well as the general decline in interest rates, Bank Negara announced on December 28, 1987 the termination of the NIF upon the full utilisation of the allocated funds. As at end December 1990, a total of $1.4 billion was approved under the NIF, of which the manufacturing sector accounted for almost three-quarter (72 per cent), followed by the agriculture sector, 19 per cent; tourism, 6 per cent and the remaining 3 per cent to the cash crop sector. In 1988, the Enterprise Rehabilitation Fund (ERF) was set up by Bank Negara Malaysia to provide financial assistance to ailing but viable enterprises under dedicated management (or on-going projects and good recovery prospects). The fund was channelled through MIDF for on-lending at concessional interest rate of 2 per cent. Among sectors which had benefited from this fund were the manufacturing, trading, housing and construction, real estate and the agriculture sectors. The response to this fund had been favourable. A total of $480 million was approved as at end-December 1990. Two dominant sectors have benefited from the fund, namely, the housing and construction sectors which as a group took up more than 60 per cent of the fund. The year 1988 also saw the setting up of the ASEAN-Japan Development Fund (AJDF), which was launched by the Government of Malaysia in corporation with Japan. The AJDF worth $895 million was set up for the purpose of providing medium-term concessional financing to the small and medium-scale enterprises in the manufacturing, agricultural and tourism sectors. The term or interest rates was fixed at 6.5 - 7.85 per cent for a period of 5 years. The Central Bank also launched the $250 million New Entrepreneurs Fund (NEF) in December 1989 in line with the Government's efforts to achieve the New Economic Policy through the provision of funds for new ventures by Bumiputera at reasonable cost. As at end 1990, a total of $21.7 million was approved under the NEF. The most recent fund launched by the Government in early 1991 was the Industrial Adjustment Fund (IAF), set up to facilitate the rationalisation and restructuring of selected industries by providing companies with medium-term loans. The initial allocation for the IAF was $500 million, whereby three industries namely the wood-based, textiles and machinery and engineering industries were selected as pioneers to the scheme. This fund would be administered by the Central Bank. It can be seen that the establishment of these funds were directed at certain target sectors, which the Government wanted to promote by providing financing at terms that are more favourable than those available in the market. A brief summary of all these funds is in Table 8.15.

2.2 Organisation Chart of Credit Department in Bank Negara Malaysia

Since there is no specific department dealing with credit operations in Bank Negara Malaysia, there is no specific organisation chart per se. However, the Accounts Department which is acting as the fiscal agent of the Government is empowered under the Loans (Central Bank of Malaysia) Act, 1960 to undertake the issue and management of the Government's domestic loans. The Department also services and maintains all public debts records for the Government.

2.3 Regulations and Supervisions

Prior to the implementation of the Banking and Financial Institutions Act, 1989 (BAFIA) in October 1989, the Central Bank of Malaysia exercised its regulatory roles within the framework of the Banking Act, 1973 (for the commercial banks and merchant banks) and the Finance Companies Act, 1969 (for the finance companies). Hence the introduction of BAFIA was intended to provide for an integrated supervision of the Malaysian financial system and to modernise and streamline the laws relating to banking and all other financial institutions presently supervised by the Bank, including those supervised on an administrative basis to be placed under one supervisory and regulatory body (i.e. the Central Bank). BAFIA would enable the Central Bank to supervise three broad groups of financial institutions, namely, the licensed institutions, scheduled institutions and the non-scheduled institutions. The group of licensed institutions comprises major deposit-taking institutions, namely, the commercial banks, merchant banks, finance companies and discount houses, as well as money-brokers, which are being closely supervised by the Central Bank. The scheduled institutions comprises credit and charge card companies, building societies, factoring and leasing companies and also the development finance institutions. At present all the scheduled institutions were not subject to any formal regulation or supervision. However, if deemed necessary, the Minister of Finance may, on the recommendation of the Central Bank, extend in whole or part the regulatory regime applicable to the licensed institutions to any of the scheduled institutions. Finally, the non-scheduled institutions, comprises the statutory bodies or persons of corporations which are neither liable to be licensed under the BAFIA. They are usually engaged in the provision of finance, that is, money lending, leasing, factoring, purchase of financial papers and the acceptance or guarantee of any liability or obligation of any person. The operations of these institutions are not governed by BAFIA. However, BAFIA allows, during an emergency or crisis situation, for the Minister of Finance, upon the request of the relevant ministries in charge of these institutions, to direct the Central Bank to investigate and take corrective actions, including assumption of control. Thus, in short, BAFIA sets out a practical and expedient system to achieve an integrated supervisory regime for a wide spectrum of the Malaysian financial system. As the prime monetary authority, the Central Bank was also empowered to conduct periodic examinations and investigations into the affairs of the commercial banks (including Islamic Bank), finance companies, merchant banks, discount houses, insurance companies and the deposit-taking institutions. This responsibility was undertaken by the Bank Examination Department Supervision of the banks and non-banks were intended to ensure that banking operations were soundly con-

Table 8.15

LOANS CONDITIONS OF MAJOR LONG-TERM FUNDS

(As at the end of 1990)

Name of Funds	Objectives	Implementing Institutions	Interest Rates (p.a)	Maturity (Years)
New Investment Fund (NIF)	To help stimulate new fixed investments in selected sectors, namely, manufacturing, agriculture (including cash-crop), tourism and mining sectors.	Commercial banks and selected DFIs namely the MIDF, Industrial Bank and Development Bank.	7.75%	Max.5
Enterprise Rehabilitation Fund (ERF)	On-lending to ailing but viable Bumiputera enterprises.	Major creditor banks	Max 2%	case to case basis
ASEAN-Japan Development Fund (AJDF)	To provide financing for SMEs for new investment and expansion in the manufacturing, agriculture and tourism sectors.	Development Bank of M'sia, Agricultural Bank of M'sia, Industrial Bank and MIDF	6.5% -> OECF funds 7.85% -> EXIM bank	Max 15 years
World Bank Sponsored Small Enterprises Loan Scheme	To assist Bumiputera small-scale enterprises. This scheme was later extended to non-Bumiputeras.	MIDF and Development Bank of M'sia	-	3-8
New Entrepreneurs Fund (NEF)	For funding of new ventures by Bumiputera at reasonable cost.	Malayan Banking Bhd., UMBC, Perwira Habib, MIDF and Development Bank of M'sia	Max 5%	5
Special Fund for Tourism	To stimulate new fixed investment in the tourism sector.	Commercial banks and merchant banks	Max 7.75%	5
Industrial Technical Assistance Fund (ITAF)	To provide matching grants and loans to assist SMEs in conducting feasibility studies and R & D.	SIRIM, Development Bank of M'sia and M'sia Export Trade Centre (MEXPO)		To be fully disbursed by 1995
Abandoned Housing Projects Fund	To help housing developers and banks revive abandoned housing projects.	Major creditor banks	Max 2%	case to case basis
Industrial Adjustment Fund (IAF)	To facilitate the rationalisation and restructuring of selected manufacturing industries by providing companies with medium-term loan.	Industrial Bank of M'sia, Development Bank of M'sia and MIDF	Max 7.75%	8 years

ducted in the interest of the public in general and the depositors, in particular. The inspection was mainly directed at the investment and lending policies of the bank, the state of its assets, the quality of management and compliance with the various statutory requirements. Arising from past experience, Bank Negara Malaysia had laid down further prudential guidelines for the banks on capital adequacy requirements, limit on lending to a single customer, treatment of non-performing loans, responsibilities of bank directors and the formation of audit committees.

2.4 Implications for the Central Bank

As mentioned earlier, Bank Negara Malaysia does not participate directly in long-term financing. Its involvement is only confined to providing/channelling funds for special scheme set up by the Bank or the Government for on-lending through the banking institutions and specialized institutions (such as the IFIs and ACIs) to the target sectors. In order to ensure that funds disbursed to the participating institutions (for special funds) are channelled to the eligible sectors and borrowers (who met the loan eligibility criteria) and do not deviate from the main objectives of the funds, regular and specific reporting system to the Treasury and Central Bank (wherever applicable) is made compulsory. Through these periodic reports, the necessary monitoring and checks can be carried out. The Banking and Financial Institutions Act (BAFIA), 1989 which provides for an integrated supervision of the Malaysian financial system and aimed at modernising and streamlining the laws related to banking also governed the operation of the long-term financing provided by the financial institutions.

III. Issues and Suggestions in Long-Term Financing for Manufacturing and Agricultural Sectors

3.1 Issues Related to Long-Term Institutional Credit

3.1.1 Access to Institutional Credit

As the nation's foremost financial institutions, the Central Bank is called upon to assume the role of ensuring that national development is appropriately financed. In particular, the Central Bank's role will be centered at providing and facilitating the flow of funds at the macro-level and at directing and influencing the allocation of funds to different sectors of the economy. In Malaysia, Bank Negara had, through moral suasion urged the financial institutions, to adopt credit policies and techniques which were more development-oriented. This had resulted in the reduction of their traditional concentration in the financing of trade in favour of other priority sectors in the country's development programmes. However, any fundamental change in the direction of bank lending was a slow process. Bank Negara's experience had been that while some banks would respond positively to the priority sectors, moral suasion would not work well in all cases. In order to ensure that credit would be directed for productive purposes, credit guidelines were imposed and revised from time to time to take into account changing circumstances. The guidelines issued had nevertheless serve useful where it spelt out the extent and depth to which the Central Bank can effect the direction of bank lending, which also include the cost of lending. Against this background, there were still shortcomings which had limited access to institutional credit. In case of the agricultural credit, it was observed that although the volume had increased substantially, the bulk of this credit had been channelled to big borrowers namely the large farmers and estate growing cash crops rather than the smaller ones. The small farmers' access to institutional credit were somewhat limited by several factors including the complexity and formality of procedures involved in credit programmes; the status of the small farmers who were landless or marginal farmers with uneconomic land holdings; lack of information regarding the financing schemes available; and unwillingness of banks to lend since banks are often unsure of the viability of small projects.

3.1.2 Repayment Problems

On the other hand, credit institutions which provide agricultural credit programmes have found themselves saddled with increasing bad debts. From the view point of the credit institutions, one of the problems of retailing credit to small farmers was the fact that the amount involved was very small and the cost of credit appraisal and recovery can be very high. Moreover, credit institutions had difficulty in extending loans for agriculture in view of their limited expertise in evaluating the risks involved in this sector. In case of default, litigation may be undesirable in view of the small size of loan and the adverse publicity associated with a large bank taking court action against small agricultural borrowers. In addition, due to the inherent risks associated with agriculture which were often subjected to the vagaries of nature, banks had been reluctant to finance projects of this sector. Banks were also reluctant to finance agriculture or cash-crop cultivation which were cultivated on "Temporary Occupied Land" (TOL) or on railway reserves, road and transmission line reserves. It was unfortunate to note that farmers were generally not aware that credit was an instrument for increasing their production and income. As a result, credit received has been used for consumption purposes rather than for productive purposes. Here the fault may lie as much with the agencies allocating the credit as with borrowers. Improper credit allocations procedures and failure to properly follow-up on loans disbursed had generally resulted in bad debts. The policies and procedures with regard to the repayment of the long-term financing for the agriculture and manufacturing sectors varies among financial institutions. Generally, most long-term loans granted by the credit institutions provided for some grace period before repayment. In Malaysia, unfortunately, poor repayment attitude was most prevalent amongst borrowers from small production units in areas where Government subsidies were high. Borrowers often have the impression that financial schemes made available by the Government are subsidies for which they were reluctant or not oblige to pay. However, due to a lack of data and supporting information, the extent of the repayment problems such as loan defaults or loan deliquency could not be quantified.

3.1.3 Bias Direction of Lending

In the case of the manufacturing sector, although loans (all type) extended by the banking system to the sector had increased significantly over the last two decades from $481 million in 1970 to $26.9 billion in 1991, or an average annual increase of 21.2 per cent. These loans, however, were mainly directed towards the capital-intensive and high technology industries, namely, those producing the electrical machinery and appliances; iron and steel products; and wood and wood products (or a share of 13.3 per cent, 9.3 per cent and 8.9 per cent respectively of total banks' loans). During the same period (1980-1991), consistent with the growing importance of the non-resource based industries in the economy, the share of loans extended to this sector rose from 52.8 per cent at end 1980 to 60.3 per cent as at end 1991, against a decline of 7.5 percentage points over the same period for the resource-based industries (1980: 47.2 per cent; 1991: 39.7 per cent).

3.1.4 Collaterals Problems

It was widely perceived that despite the availability of soft loans by the Government to the priority sectors, the small and medium scale entrepreneurs (SMEs) in general continued to face problems in obtaining financing from the banking system. This was due mainly to factors which include the requirement to provide collateral against the loans extended to the SMEs of which these applicants usually do not have adequate assets to pledge against their loans and no track record to back their applications. On the other hand, the reluctance of bankers to extend such loans was due to high administrative cost and large number of defaults. This had resulted in the tight screening and subsequently in the long delay of loan processing.

3.1.5 Lack of Information on Financing Facilities

This problem was particularly evident amongst the small entrepreneurs in both the agricultural and manufacturing sectors who were located in rural areas and who were illiterate. Their unawareness was reflected in the reported poor response from the agro-based sector towards the \$195 million allocated under the AJDF to the Agricultural Bank, where to date only \$40 million was disbursed, out of the \$82 million approved. Similar case was noted for the ITAF Scheme where it was reported that many SMIs were not aware of all the four schemes under the ITAF.

3.2 Future Needs of Long-Term Financing for Manufacturing and Agricultural Sectors

Malaysia has set its sights on achieving the status of a fully developed nation by the year 2020. In view of this, the Government is committed towards providing the necessary support and encouragement. In the area of financial support, the Government would devise appropriate assistance to accelerate the industrialisation drive towards achieving the 2020 Vision.

In the process of industrialisation, it is important and timely to improve on the technological capabilities of firms to enhance their competitiveness. As such, financing should therefore, be made available for the upgrading of machineries to replace obsolete machinery and equipment, and also to support research and development (R & D) so as to ensure that the quality of goods produced would be in line with the rapid changes in the world demand. Also related to this issue is the human resource development which is indeed one of the most important prerequisities in upgrading the efficiency of the production units.

In the case of the agricultural sector loans, future lending activities by the commercial banks are expected to improve as confidence returns. Lending to small farmers under the Special Integrated Agricultural Loan Programme (SPKP) offered by the Agricultural Bank is expected to increase significantly as the need for capital requirements by farmers increased with the higher demand for agricultural produce and given that subsidy provisions are being curtailed. However, the provision of subsidies for padi and for input such as seeds, fertilisers and stimulants to stimulate production and for socio-economic reasons, would remain.

3.3 Recommendations for Further Improvements

The main thrust of the future industrial development should address the following issues: to diversify the narrow industrial base, which is traditionally being dominated by one or two subsectors; to strengthen industrial linkages between the larger and small firms; to gear the economy towards capital-intensive and technologically sophisticated industries which provide better quality and competitive products; and to sustain the growth momentum of the resource-based industries. In line with these goals, the industrial promotion drive would demand a more serious and stronger commitment from the financial institutions. Looking back, during the last two decades, Malaysia had successfully shifted from the exports of resource-based industries to the non-resource based industries. Therefore, in view of the comparative advantage that Malaysia has in the production of the resource-based products, efforts must be made to ensure greater downstream activities to increase value added activities in these industries. This could be achieved through larger contributions from the small and medium-scale industries (SMIs) which has long been the backbone of the Malaysian industry. In relation to this, the financing needs for industrial development should therefore also concentrate on developing the SMIs to enable them to contribute more effectively to the economy. In this regard, the financial institutions need to be more innovative in creating new types of financial instruments which can be used effectively to finance and support industrial development. Among areas which financial institutions could consider going into seriously were the venture capital and debentures financing. Venture capital would undoubtedly has an important role to play, particularly for the financing of non-conventional ventures where the risks attached are normally higher. Indeed the availability of venture capital would further boost investment in the long run. In addition, concerted efforts to develop the corporate bond or private debt securities (PDS) market should also be made. To facilitate bond issues, the Rating Agency Malaysia Berhad (RAM) was set up to assess the creditworthiness of bond issuing companies, hence facilitating bond issues. This would encourage more potential investors to raise funds directly from the market. Furthermore, trading in the secondary Malaysian Government securities market needs to be enhanced and depended to further increase liquidity and allocative efficiency. A financial future market will also need to be established. The Government has given initial approval for the setting up of the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE). For the nation's financial system to evolve into a strong market-oriented centre, the availability of hedging facilities is essential where players would be in a better position to manage their financial risks.

The achievement of the growth and structural transformation targets towards the year 2020 would depend critically on Malaysia's ability to increase its exports, particularly manufactured goods. This would require pragmatic domestic policies to meet the dynamic external challenges and changes. Malaysia currently has a wide range of export incentives and assistance schemes to promote exports. These incentives and export schemes have been effective in stimulating the exports growth in the past. Nevertheless, taking into account recent trends and development, it may be timely to review and evaluate the effectiveness of existing export promotion and financing schemes and to assess whether it is timely to establish an export-import bank (EXIM) in Malaysia, to effect a smooth transition to a fully developed nation status by the year 2020. In relation to this issue, the existing roles and functions of the various institutions in Malaysia appeared to complement each other - the banking system providing short-term export financing and Bank Industri, the medium to long-term financing needs of exporters of capital goods. MECIB or the Malaysian Export Credit Insurance Berhad, on the other hand covers the insurance needs of both borrowers and lenders of trade financing. The present institutional set-up of Bank Industri and MECIB is very conducive for them to be merged into an EXIM bank. A fully integrated institution would be more effective in ensuring smooth operations and more strategic exports promotion. Simultaneously, Bank Negara would continue to operate the ECR scheme for short-term financing of eligible exports, as well as the Bilateral Payment Arrangement which takes care of special exports to difficult markets.

On the whole, it can be concluded that the pattern of future industrial financing would be determined largely by the requirements of the manufacturing sector. It may be necessary to concentrate financing in selected industries which have high value added and those with linkages to the resource-based sector. Financing should also be directed to ancillary and supporting industries, they may also at the same time provide the nation with new fundamentals of growth. In short, the financial system has to respond positively by providing a broader and more flexible range of financial instruments not only for borrowing but also for the hedging of risks.

With regard to financing for the agriculture sector, it must, for practical purposes, aimed at reducing the cost of loans and make credit more accessible to small farmers. Several possible measures to be undertaken to reach the small farmers are to employ low-cost agents (through mobile units) and appointing agents in the rural areas to channel credit. The benefits of the latter measures are two-fold. Firstly, the financial institutions would benefit from the advantages of having an existing system in the rural areas to channel credit, namely, the low administrative costs, ready accessibility and personal knowledge of farmers, and the ability to collect debts. Secondly, this method would broaden the coverage of the bank's lending operations in the rural areas and provide better accessibility for the farmers. This method had been adopted by the Agricultural Bank of Malaysia (ABM) which used agents such as the Local Credit Centres for some of its credit programmes. More recently, the ABM had also been requested to set up more branches and temporary offices which the bank had responded in its recent move to set up temporary offices or "patriotic spots" in the rural areas which had provided convenient banking services to the people. There is also the need to strengthen the links between the credit programmes and the agricultural development programmes in addition to the provision of other input and marketing of agriculture produce. For the success of credit programmes, other factors other than financing should also be considered. There must be new technology, markets that can supply additional input and absorb additional output, institutions who are willing to lend to small farmers on terms the farmers consider attractive and perhaps most importantly, farmers willing to borrow, to invest and repay loans. To reduce the cost of loans, it is suggested that rural savings be mobilised for on-lending to finance agricultural activities. Another possible method is for the financial institutions to extend credit through group lending. Under this programme, credit is extended to a group of borrowers, say, a village or a group of farmers with a common project, and this group is jointly liable for the loan. These groups have the advantage of providing mutual support to their members, creating a sense of confidence, solidarity and self-reliance, which small farmers so often lack. Group lending would ensure firstly, an increasing number of farmers participating at a reduced cost of operation to the bank; secondly, it alleviates the problem of physical collateral for the loan - group lending allows for group guarantees acceptable to most credit institutions; and thirdly, group pressure may enhance repayment to ensure continued financing of their projects. Some of the examples of group financing undertaken by the Agricultural Bank were the Padi credit scheme, group poultry projects, development of idle land projects and the development of customary land in Sarawak. As part of its revamp programmes, the Agricultural Bank had also taken steps to tap into what it thinks is a lucrative market for banking and loan services which is long ignored by other banks - the land schemes and fishing communities. The bank had also found that settlers in land development schemes such as Felda and Felcra and fishermen were keeping large amount of cash in hand because their hours (after working hours) were unsuited to normal banking hours. This had led to some branches of ABM keeping very odd banking hours to cater for the needs of this community. It is also recommended that the lending policies and procedures for the agricultural loans need to be simplified, particularly the loan application forms, alternative security arrangements (use crop or farm produce as collaterals or rely on co-signers or group guarantee) and loan approval procedures as experience had showed that these were factors that had discourage farmers from applying for loans.

To further complement the above proposals, ABM should also undertake co-financing with the commercial banks and other agriculture credit agencies in order to increase financing specifically for agricultural food production. The need for such a scheme arises since commercial banks had difficulty in extending loans to the agriculture sector in view of their limited expertise in evaluating the risks involved in this sector, while ABM on the other hand had wide experience in this field but lacked the financial resources. Moreover, the ABM not only had the expertise in lending for the agriculture sector but also had a wide network of branches to reach the farmers. However, its (ABM) lack of funds had constrained the bank from playing a more active role in agriculture development.

Further, in order to improve the accessibility of credit to the agriculture sector, credit must be made available to meet different requirements of the borrowers by covering crops and projects of different strategic importance, loans of different level of risk, financing of innovations, the adoption of new technologies including mechanisation and also financing of exports. In view of the large tendency of agriculture loans turning into bad debts, the establishment of an Agricultural Insurance Scheme would be timely. This scheme would act as a cushion against non-repayment risk as well as provide assurance to the credit institutions of loan recovery. With regard to the non-repayment of loans, ABM had implemented several new strategies to recover problem loans. This include regionalising its operations on a State by State basis, selling of collaterals and enforcing prudence in management and limiting single largest loans to $5 million only. In addition, commercial loans for downstream and upstream business activities would be given to cross subsidise the amount of outstanding loans.

Macroeconomic policy biases against agriculture was cited as one of the reasons for its lower relative attractiveness as an investment option compared to manufacturing. One source of bias is the inadequate incentives for agriculture under the present Promotion of Investment Act (PIA), 1986 vis-a-vis manufacturing, although the inclusion of non-traditional agricultural activities in the PIA, 1986, provided a boost for private sector involvement, particularly in horticulture, forestry, fishery, livestock and floriculture. Therefore, an immediate review and suggested amendments need to be proposed to make the provisions in the PIA, 1986 more neutral.

IV. Major Findings and Concluding Remarks

In Malaysia, long-term financing is provided by all the banking and credit institutions ranging from the banking system to development finance institutions. Financing, both long and medium term particularly, are also being supplemented by several financial schemes/funds for different objectives, with their sources of funds from both local and abroad.

One prominent observation of this paper is that long-term loans extended to the agriculture and manufacturing sectors had recorded favourable growth rates growing at an average annual rate of 12.7 per cent and 20.3 per cent respectively for the period 1981-1990 against a lower average growth in total loans at 11.9 per cent for the agriculture sector and 15.7 per cent for the manufacturing sector. Another finding is that consonant with the growth trend of the agricultural sector, the ratio of long-term financing of this sector over its aggregate financing had been on the declining trend from the high of 22.8 per cent in 1980 to the lowest of 14 per cent in 1990. This trend could also be attributed to the tendency of the credit institutions, particularly the banking system, to provide loan to other more potential growth sectors, namely, the manufacturing and property sectors. On the other hand, the share of long-term loans of the manufacturing sector to total long-term financing of all sectors had been on a rising trend during the same period under review. Thus, reflecting the successful industrialisation programme of the country and the declining importance of the agriculture sector. It is also observed that long-term financing made up the bulk of the agricultural sector's total financing (averaging 78 per cent) during the period under review, while the reverse is noted for the manufacturing sector where long-term financing on average only accounted for 30 per cent during the same period.

On the significance of long-term financing for the agricultural and manufacturing sectors to GDP and value added growth, a steady annual increase is noted. The share of both the agricultural and manufacturing sectors to value added had accelerated from 23 per cent in 1980 to 49 per cent in 1990, while their contribution to GDP growth, had also been increasing steadily during the period under review from 10 per cent in 1980 to 22 per cent in 1990. With regard to the agricultural sector's contribution to total national employment, it is observed that it had declined to 27.8 per cent as at end 1990 from 37.2 per cent as at end 1980 which is somewhat in line with its declining trend of growth. The decline in the agriculture sector's employment share is attributed to the rapid growth in the manufacturing sector's employment. Nevertheless, the share of the agricultural sector's employment to total employment had always been higher than that of the manufacturing sector.

This study also showed that the setting up of development financial institutions (referred as the IFIs and ACIs in this paper) to fill the gap in the supply of financial services and facilities not usually covered by the then existing financial institutions, had proven successful, whereby both the IFIs and ACIs had become among the principal sources of long-term credit. The ACIs for instance, had played a leading role in providing medium to long-term credits. Total long-term loans extended by the ACIs accounted for 66 per cent of the aggregate long-term loans extended to the agriculture sector in 1990 (67 per cent in 1985 and 63 per cent in 1980).

Specifically on the agricultural front, it is observed that major agricultural commodities, namely, rubber, palm oil and cocoa are predominant in their shares of agricultural long-term financing. These commodities as a group accounted for an average of 79 per cent of total agriculture long-term financing during 1980-1990. On the other hand, the declining importance of some minor commodities, namely, padi, coconut and tobacco, in their contribution to the overall growth of the agricultural sector had been translated in their lower shares of long-term financing. With respect to the sources of agricultural credit, three major groups of institutions, namely the banking system, the Government development agencies and the rural credit institutions remain as the primary source of financing. Among these institutions, the contribution of the Agricultural Credit Institutions (comprising the Government development agencies and the rural credit institutions) in long-term financing of the agriculture sector remained predominant. It is also observed that although the banking system remain as the largest provider of agricultural credit (all type), its share in the long-term financing to the agriculture sector is not significant and is relatively lower than those of the ACIs. Further, although the agriculture sector had been receiving increased credits from the banking system, the main beneficiaries have been the big borrowers rather than the small farmers. The Government had sought to rectify this imbalance by setting up various agencies to channel funds to the rural poor. One such scheme is operated by Felda which had suceeded in lowering the incidence of poverty in the rural areas. Despite the provision of special loan schemes and attractive loan sweeteners to the lending institutions, the Malaysian experience suggests that lending to small farmers has yet to be viewed as a profitable venture by these institutions. The high incidence of 'bad' loans to this sector, perhaps justifies this point of view.

The prospects are that the Malaysian economy would remain strong and the manufacturing sector is expected to continue to be the nation's main engine of growth. In this regard, the banking system which is the main channel through which funds are mobilized and allocated to the various sectors of the economy has a key role to play. Without a sound and stable banking system, which keeps savings intact and continually provides the flow of credit, the industry cannot prosper. As the manufacturing sector moves closer to the level of maturity befitting an industrialised economy, much more resources are needed to finance expansion and modernisation of productive capacity. This would be translated into greater lending and investment opportunities for the banking industry. Taking into account the impact of further industrialisation, which would quicken the pace of loan expansion, the banking industry certainly has an enormous potential for rapid growth and good profits. Besides the expansion of market size, industrialisation of the economy would inevitably lead to demands for a wider range as well as more complex financial services and instruments. To cater for the sophisticated needs of bank customers, particularly the corporate sector, banks would have to be more dynamic and innovative in order to provide a broader and more flexible range of instruments both for borrowings as well as for hedging of risks or in the words of the Bank Negara Malaysia's Governor, "If the Malaysian financial system is to play an effective role in the creation of a prosperous Malaysian society, it must develop the ability to change with the times and circumstances". There would also be a greater shift of credit flows from bank lending to marketable debt instruments through the securitisation process. Increasingly, banks would have to be the purchasers of debt securities as well as arrange and manage new issues, instead of being the direct lenders to the borrowers, particularly the high-grade corporate borrowers. To ensure that the banking system undertakes its role as the nation's chief mobilizer of savings and provider of credit more effectively and efficiently, Bank Negara had adopted a two-pronged strategy of supervisory re-regulation and structural deregulation with the objectives of enhancing efficiency, while at the same time strengthening the system's prudential standards, discipline and moral fibre. This approach by Bank Negara would continue into the year 2000. Correspondingly the Central Bank would continue to put into place measures to improve banking discipline and professionalism, and judiciously introduce financial reforms to enhance efficiency in the financial sector.

Finally, it can be concluded that in order to effectively boost productivity and growth in the agriculture and manufacturing sectors, Malaysia's experience points to the need for a good management and co-ordination amongst all the agencies and institutions involved. The availability of credit is not the panacea. It calls for co-ordination all the way from the basic requirements of both the agriculture and manufacturing sectors to the provision of complementary input and services. The availability of finance and credit (be it short, medium or long-term) is only the final string that ties the whole package together.

Bibliography

1. *Bank Negara Malaysia Annual Report,* 1980-1990 issues.

2. Money and Banking, Bank Negara Malaysia 1st, 2nd and 3rd Editions.

3. Bank Negara Malaysia, Monthly Statistical Bulletins, various issues.

4. Bank Negara Malaysia Loan Statistics of the Banking System 1980-1990.

5. Bank Negara Malaysia Speeches and Materials for Speeches, 1988-1990.

6. Bank Negara Malaysia Lending Guidelines Circulars to Relevant Financial Institutions, 1980-90.

7. Article on *'Review of Export Promotion and Export Financing Scheme',* Bank Negara Malaysia, January 1992.

8. Central Banking in an Era of Change: Landmark Speeches: 1959-1988, Bank Negara Malaysia, 1989.

9. Bank Negara Malaysia: Survey of Private Investment in Malaysia, 1988-1991.

10. SEACEN Staff Papers No. 35 *'The Recent Trends in Agro-Industrial Credit Facilities: Problem and Issues in the SEACEN Countries',* March 1990.

11. Seminar paper on 'Non-tariff Incentive Policies' by Dr. Ismail Muhd. Salleh, 1990.

12. *Annual Report* and/or Annual Data of the MIDF, Bank Industri, Bank Pembangunan, Borneo Development Corporation, Sabah De velopment Bank, Bank Pertanian, Felda, Farmers' Organisation As sociation, Bank Rakyat, Rural Credit Institutions and Credit Guar antee Corporation (CGC), 1980-1990.

13. Pamplets/brochures on loans of the MIDF, Bank Industri and other development institutions quoted in the study.

14. Report of the *Review of the NAP (National Agricultural Policy)*, Ministry of Agriculture, December, 1991.

15. Speech on the 'Role of the Financial System' by Bank Negara Malaysia, Governor, Yang Bhg. Tan Sri Jaffar Hussein accepting the Honorary PhD conferred by Universiti Utara Malaysia, November, 1991.

16. Data and Operational Guideline for the Implementation of AJDF in Malaysia and its Status Report (latest).

17. Operational Guidelines for all Funds Quoted in Paper Namely NIF, NEF, ERF, ITAF, etc.

18. Sixth Malaysia Plan - 1991-1995 - Chapters on Industrial Develop ment and Agricultural Development.

19. Paper on *'Agricultural Credit Programmes and Practises and Specific Problems in Credit Management'* - produced by Bank Pertanian Malaysia and published by Asian and Pacific Regional Credit Association (APRACA), 1989.

20. Paper on Agro-Industrial Credit Facilities in Malaysia, produced by the Economics Department, Bank Negara Malaysia for the SEACEN Staff Papers No. 35 (refer 8 above).

21. Briefing notes for the visit of the Minister of Economics, Planning and Finance Republik Demokratik Rakyat Lao entitled Finance for Agriculture: The Malaysian Experience, November 1989.

22. Box Article for *Bank Negara Malaysia 1991 Annual Report on Financing of Industrialisation,* March 1992.

23. Fifth Malaysia Plan Mid-Term Review, 1986-1990.

24. Press release on the CGC's New Guarantee Scheme - The Principal Guarantee Scheme (PGS), March 30, 1989.

25. Bank Negara Malaysia Board Paper on Insurans Kredit Eksport Malaysia Berhad (MECIB), Oktober 1991.

26. Article on Finance for Agriculture - Banking Journal of Malaysia, March 1981.

27. Newscuttings.

Note to the paper

1. Due to the nature of the banking system and the development finance institutions data which do not have standard definition for long-term loans, long-term financing is defined as loans with original maturity of over one year.

2. Sources of long-term financing for the manufacturing sector consist of the banking system and the industrial finance institutions (IFIs) and data quoted in this paper refers to their outstanding loans as at year-end.

3. IFIs consists of the MIDF, Bank Pembangunan, Bank Industri, Sabah Development Bank and Borneo Development Corporation.

4. Sources of long-term financing for the agricultural sector comprising the banking system and the agricultural credit institutions (ACIs). Data on agricultural long-term financing refers to the banking system and ACIs outstanding loans as at year-end.

5. ACIs consists of Government Development Agencies, namely, Felda and Sabah Development Bank; and Rural Credit Institutions comprising the Bank Pertanian, Bank Rakyat, Farmers' Association Organisation (FOA), farmers' co-operatives, agro-based co-operative societies and rural credit co-operative in Sabah and Sarawak.

6. Total long-term financing for all sectors refers to all long-term credit by the Banking System, ACIs and IFIs (Refer Table 1).

7. Due to the unavailability of data on outstanding loans of the CGC, analysis on the CGC loan portfolio can only be based on approvals.

8. Manufacturing sector in this paper comprises the 14 major industrial groups, while agricultural sector refers to the major commodities i.e. the cash crop sector and other agriculture. The mining and fisheries sectors are not included.

Industrial Finance Institutions

Institution	Purpose of Establishment	Year Established	Relevant Legislation
Borneo Development Corporation Sdn. Bhd. 1/	To assist on the economic diversification of the predominatly agricultural economics of Sabah and Sarawak.	mid-1950s	Founded by the Commonwealth Department Corporation
Malaysian Industrial Development Finance Bhd.	To provide medium to long-term capital for industrial enterprises through loans and direct equity participation. It also supplies leasing finance for industrial plant and equipment.	1960	Companies Act, 1960
Development Bank of Malaysia Bhd.	To promote the participation of Bumiputeras in commerce and industry especially in the provision of equity capital financing.	November 1973	Companies Act, 1973
Sabah Development Bank Berhad	To provide medium and long-term loans to private and state enterprises in the agriculture, commercial, manufacturing, electricity and the real estate sectors in the state.	August 1977	Companies Act, 1977
Industrial Bank of Malaysia Bhd. (formerly known as Industrial Development Bank of Malaysia Bhd.)	As a long-term credit bank to promote and help finance the expansion of productive capacity in capital intensive and high technology industries with a long gestation period, such as shipping and the shipbuilding and repair industry. It's activities were later expanded to include long-term credit for the exports of capital goods and in September 1988, the bank took over the entire shareholders of the Malaysia Export Credit Insurance Berhad (MECIB). The bank together with MECIB later launched nationwide the new Export Credit Insurance and Guarantee Scheme in conjunction with the launching of a revamped Export Credit Refinancing Scheme (ECR).	August 1979	Companies Act, 1979

1 Effective from July 30, 1991, the Borneo Development Corporation by virtue of its nature of business will not be considered as one of the industrial finance institutions.

Chapter 9

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN NEPAL

by

Narayan Prasad Manandhar

I. An Overview of the Existing Condition of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Introduction

Nepal is a small landlocked country sandwiched between two giant countries of Asia. It has an open border with India on its east, west and south parts, while the north borders with the Tibet region of China. It is surrounded by high altitude snowy mountains with only one highway outlet with the Tibet region of China. The highway connected with the Tibet region of China could not have been fully utilised for trade since most of the industrial and trade centres of China are located in the south eastern part, in this situation, even the trade with China has to be carried out via India's Calcutta port. The precarious landlocked position of Nepal is better illustrated by the Nepal India trade and transit stalemate during the period March 1989 to May 1990. During this period, the Nepalese economy had experienced a great set-back.

About 77 per cent of Nepal's total area consists of mountains, hills, elevation plains and river valley. The rest of the total area of the country is the Terai (Plain). Transport system in Nepal is very poorly developed due to the irregular mountainous terrain. The transport and communication system in the Terai region of the country is highly developed in comparison to the hills and the mountains. About 80 per cent of manufacturing activities and the principal agricultural region representing about 70 per cent of the total cultivated land in the country is located in the Terai. Under such circumstances, it is natural to concentrate investment both in the agriculture and manufacturing sectors in the Terai region. The irregular mountainous terrain accompanied by landlocked location has been a major physical constraint for a balanced development throughout the country.

Nepal is predominantly an agricultural country with 90 per cent of its population directly involved in agriculture. The agriculture sector in 1989/90 contributed 61 per cent to GDP. Since agriculture plays a dominant role in the Nepalese economy, the increase in the production of agriculture is essential to improve the welfare of the people. Industrial development also has an important role to play in the Nepalese economy for reducing the overdependence on agriculture. Moreover, industrial development is largely dependent on agriculture for its raw materials. In this way, both the agriculture and industry compliment each other in Nepal.

The history of the modern banking development in Nepal is very short. The first public limited bank, Nepal Bank Ltd., was established in 1938. However, it took decades to develop some other financial institutions. The presence of a few banks in the country inevitably turned into a state of monopoly, which is responsible for the slow growth in agriculture and manufacturing sectors' financing. However, the participation of a few foreign banks with the Nepalese banks and the public, created a healthy competition among the domestic and foreign banks in investment. This is a positive development, which will certainly help to create a sound banking system in Nepal.

1.2 Nature of Long-Term Financing for Manufacturing and Agricultural Sectors

A cursory glance on the contribution of agriculture and manufacturing sectors to GDP during the 10 years period showed that improvement in the manufacturing sector was achieved, thereby reducing the share of agriculture to GDP (Table 9.1). In the year 1980/81, the share of agriculture and manufacturing to GDP were 59.9 per cent and 40.1 per cent respectively, while in 1989/90 the sectors contributed 60.9 per cent and 39.1 per cent respectively.

Bank financing in the agriculture and manufacturing sectors had increased by 16 times, and 6 times respectively during the last 10 years (Table 9.2). Banking sectors' investment in agricultural and manufacturing as a proportion of GDP were just around 0.6 per cent and 2.4 per cent respectively in 1980/81. The investments, however, increased to 3.2 per cent in agriculture and 4.7 per cent in manufacturing in 1989/90.

The value added in the agriculture sector as a proportionate share of bank finance in agriculture was 1.1 per cent in 1980/81 but went up to 5.9 per cent in 1989/90 (Table 9.3). There was also a rise in bank finance during the last 10 years in the manufacturing sector which is exhibited by the fact that the proportionate share of value added in manufacturing shoot up from 5.7 per cent to 10.2 per cent.

Bank financing for both the agriculture and manufacturing in comparison to total export earnings in 1980/81 were 10.3 per cent and 41.0 per cent respectively (Table 9.4). In 1989/90, agriculture finance increased to 63.5 per cent of total export earnings and manufacturing finance increased to 94.0 per cent of total export earning. During the period of 1980/81 - 1989/90, bank financing in agriculture multiplied by nearly 16 times, while in manufacturing it increased by 6 times. However, the total export earnings increased only by 2.6 times.

The Agricultural Development Bank (ADB) is playing a vital role in the overall development of agricultural activities in the country. In 1980/81, the ADB had invested Rs. 134.1 million in the agricultural sector which increased to Rs. 1,172.5 million in 1989/90 (Table 9.5). In 1980/81, investment in short term credit was 60.9 per cent of the total investment followed by medium term credit of 30.5 per cent and long term credit of 8.7 per cent. In 1989/90, the short, medium and long term credits of the total investments were 47.2 per cent, 47.3 per cent and 5.5 per cent respectively. The share of short-term credit declined from 60.9 per cent to 47.2 per cent of the total investment during the 10 years period, however, a considerable increment in medium term credit was observed during the review period. The long-term credit recorded a sharp fall from 8.7 per cent to 5.5 per cent of total investment during the period under review.

According to available data on investment by type of activity of Agricultural Development Bank during 1980/81, 29.2 per cent was invested on food grains and cash crops; 12.8 per cent on agricultural tools and irrigation; 16.9 per cent on agriculture business; 33.5 per cent on agriculture industries, marketing and godowns; 2.3 per cent on horticulture and 5.4 per cent on tea and coffee plantation (Table 9.6). Investments during 1989/90 made on food grains and cash

Table 9.1

GROWTH RATE AND SHARE OF AGRICULTURE AND MANUFACTURING AS COMPONENTS OF GDP

Year 1/	Annual Growth Rate		Share (%) of GDP	
	Agriculture	Manufacturing 2/	Agriculture	Manufacturing 2/
1980/81	10.4	5.5	59.9	40.1
1981/82	4.6	2.6	60.3	39.7
1982/83	-1.1	-5.8	61.5	38.5
1983/84	9.5	9.9	61.4	38.6
1984/85	2.4	12.2	59.2	40.8
1985/86	5.1	3.1	59.7	40.3
1986/87	0.5	8.9	57.7	42.3
1987/88	8.1	7.4	57.9	42.1
1988/89	6.4	-3.3	60.2	39.8
1989/90	3.2	0.2	60.9	39.1

1 The Nepalese Fiscal Year generally begins on July 16 and end of July 15.
2 Manufacturing refers to non-agricultural sector.

Table 9.2

BANK FINANCE IN AGRICULTURE AND MANUFACTURING AS A PROPORTION OF GDP

(Million Rupees)

	Bank Finance		Total GDP at Current Price	Proportionate Share of Total GDP to Bank Finance	
Total	Agriculture 1	Manufacturing 2	3	Agriculture 3 & 1	Manufacturing 3 & 2
1980/81	165.6	658.8	27307.0	0.6	2.4
1981/82	314.0	344.0	30988.0	1.0	1.1
1982/83	420.3	622.0	33761.0	1.2	1.8
1983/84	594.1	516.5	39390.0	1.5	1.3
1984/85	729.4	931.2	44417.0	1.6	2.1
1985/86	812.7	1853.8	50428.0	1.6	3.7
1986/87	764.0	2181.4	59296.0	1.3	3.7
1987/88	1407.2	2732.4	69513.0	2.0	3.9
1988/89	2174.8	3245.8	77414.0	2.8	4.2
1989/90	2689.7	3981.4	84911.0	3.2	4.7

Table 9.3

BANK FINANCE IN AGRICULTURE AND MANUFACTURING AS A PROPORTIONATE SHARE OF VALUE ADDED

(Million Rupees)

Year	Bank Finance		Value Added		Percentage	
	Agriculture	Manufacturing	Agriculture at Current Price	Non Agriculture at Current Price		
	1	2	3	4	3&1	4&2
1980/81	165.6	658.8	15679.0	11638.0	1.1	5.7
1981/82	314.0	344.0	17903.0	13085.0	1.8	2.6
1982/83	420.3	622.0	19282.0	14479.0	2.2	4.3
1983/84	594.1	516.5	22771.0	16619.0	2.6	3.1
1984/85	729.4	931.2	24171.0	20246.0	3.0	4.6
1985/86	812.7	1853.8	26819.0	23609.0	3.0	7.9
1986/87	764.0	2181.4	30759.0	28487.0	2.5	7.7
1987/88	1407.2	2732.4	36032.0	33491.0	3.9	8.2
1988/89	2174.8	3245.8	41658.0	35756.0	5.2	9.1
1989/90	2689.7	3981.4	45848.0	39063.0	5.9	10.2

Table 9.4

BANK FINANCE IN AGRICULTURE AND MANUFACTURING AS A PROPORTIONATE SHARE OF TOTAL EXPORTS EARNINGS

(Million Ruppees)

Year	Bank Finance		Total Export Earnings	Proportional Share of Total Export Earnings (%) to Bank Finance	
	Agriculture	Manufacturing		Agriculture	Manufacturing
	1	2	3	3 & 1	3 & 2
1980/81	165.6	658.8	1608.7	10.3	41.0
1981/82	314.0	344.0	1491.5	21.1	23.1
1982/83	420.3	622.0	1132.0	37.1	54.9
1983/84	594.1	516.5	1703.9	34.9	30.3
1984/85	729.4	931.2	2740.6	26.6	34.0
1985/86	812.7	1853.8	3078.0	26.4	60.2
1986/87	764.0	2181.4	2991.4	25.5	72.9
1987/88	1407.2	2732.4	4114.5	34.2	66.4
1988/89	2174.8	3245.8	4195.3	51.8	77.4
1989/90	2689.7	3981.4	4235.5	63.5	94.0

Table 9.5

AGRICULTURAL DEVELOPMENT BANK LOANS BY TERMS OF CREDIT

(Million Rupees)

Year	Total		Short Term		Medium Term		Long Term	
	Amount	%	Amount	%	Amount	%	Amount	%
1980/81	134.1	100.0	81.6	60.9	40.9	30.5	11.6	8.7
1981/82	256.4	100.0	172.8	67.4	73.3	28.6	10.3	4.0
1982/83	345.8	100.0	182.3	52.7	148.9	43.1	14.6	4.2
1983/84	474.3	100.0	266.7	56.2	196.4	41.4	11.2	2.4
1984/85	583.8	100.0	254.7	43.6	310.3	53.2	18.8	3.2
1985/86	663.8	100.0	284.9	42.9	345.7	52.1	33.2	5.0
1986/87	610.8	100.0	275.8	45.2	313.8	51.4	21.2	3.5
1987/88	854.0	100.0	396.6	46.4	418.0	48.9	39.4	4.6
1988/89 1/	1017.0	100.0	451.5	44.4	529.2	52.0	36.3	3.6
1989/90 2/	1172.5	100.0	553.5	47.2	554.9	47.3	64.1	5.5

1 This figure does not include house loan for earth quake victims of 1988.

2 Includes interest capitalization of Rs. 9.2 million.

Table 9.6

AGRICULTURAL DEVELOPMENT BANK LOANS BY TYPES OF ACTIVITY 1/

(Million Rupees)

Year	Total		Food Grains & Cash Crops		Agricultural Tools & Irrigation		Agriculture Business		Agriculture Industries Marketing, & Godowns		Horticulture		Tea & Coffee Cultivation	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1980/81	134.1	100.0	39.1	29.2	17.2	12.8	22.6	16.9	44.9	33.5	3.1	2.3	7.2	5.4
1981/82	256.4	100.0	59.6	23.2	27.2	10.6	37.8	14.7	121.4	47.3	3.6	1.4	6.8	2.7
1982/83	345.8	100.0	101.7	29.4	66.7	19.3	59.7	17.3	104.1	30.1	4.0	1.2	9.6	2.8
1983/84	474.3	100.0	133.2	28.1	70.5	14.9	86.7	18.3	175.5	37.0	7.4	1.6	1.0	0.2
1984/85	583.8	100.0	169.3	29.0	88.2	15.1	144.9	24.8	168.5	28.9	11.5	2.0	1.4	0.2
1985/86	663.8	100.0	193.4	29.1	117.9	17.8	172.5	26.0	161.1	24.3	14.6	2.2	4.3	0.6
1986/87	610.8	100.0	187.2	30.6	91.6	15.0	161.3	26.4	147.6	24.2	18.3	3.0	4.8	0.8
1987/88	854.0	100.0	273.1	32.0	117.3	13.7	214.7	25.1	212.3	24.9	32.4	3.8	4.2	0.5
1988/89 2/	1017.0	100.0	335.5	33.0	158.8	15.6	217.2	21.4	261.3	25.7	36.7	3.6	7.5	0.7
1989/90 3/	1163.3	100.0	389.1	33.4	160.8	13.8	273.9	23.5	293.2	25.2	40.6	3.5	5.7	0.5

1 Total of Short, Medium & Long term credit.
2 This figure does not include house loan for earth quake victims of 1988.
3 Includes interest capitalization of Rs. 9.2 millions.

crops; agriculture tools and irrigation; agriculture business; agriculture industries, marketing and godowns; horticulture; and tea and coffee plantation were 33.4 per cent, 13.8 per cent, 23.5 per cent, 25.2 per cent, 3.5 per cent and 0.5 per cent respectively. During the 10 years period, the highest increment in ADB's investment is recorded in horticulture by 1,309.7 per cent while a decline in investment is recorded by tea and coffee plantation by 20.8 per cent.

Nepal Industrial Development Corporation (NIDC), is the only specialised agency in the manufacturing sector investments. Its performance during the review period is not satisfactory and its investment during the 10 years period increased by 265.5 per cent only (Table 9.7). NIDC's investment in long term finance is nearly 90 per cent and the rests were in medium and short term loans. In 1980/81, it had invested 54.1 per cent in hotel and tourism, 0.2 per cent in power, 42.1 per cent in manufacturing and 3.5 per cent in miscellaneous. In 1989/90, it has invested 17.4 per cent in hotel and tourism, 0.3 per cent in power, 65.4 per cent in manufacturing and 17.0 per cent in miscellaneous of its total investment. During the review period, miscellaneous sector investment increased by 1,675 per cent, (from Rs. 1.6 million to Rs. 28.4 million), while hotel and tourism recorded a marginal rise of 17.3 per cent from Rs. 24.8 million to Rs. 29.1 million.

The commercial banks are contributing satisfactorily to the development of the agriculture and manufacturing sectors. The bank's investment data have been categorised broadly for agriculture, manufacturing, commerce and others. The data on term wise investment of commercial banks are not available. For the 10 years period, the commercial banks' investment increased from Rs. 3,578.7 million to Rs. 12,117.2 million (Table 9.8). During the review period, the commercial banks' investment in the agriculture sector increased by nearly 49 times and the manufacturing sector by 6 times. The percentage shares of the total investment in agriculture and manufacturing of the total banks investment were 0.9 per cent and 17.1 per cent respectively in 1980/81. However, the banks investment increased to 12.6 per cent in agriculture and 31.5 per cent in manufacturing during 1989/90.

The financial institutions total investment in the economy in 1980/81 was in the tune of Rs. 3,758.6 million and increased to Rs. 13, 457.1 million in 1989/90 (Table 9.9). The agriculture finance's share in the total bank credits was 4.4 per cent in 1980/81, and increased to 20.0

Table 9.7

NEPAL INDUSTRIAL DEVELOPMENT CORPORATION LOANS BY TYPES OF ACTIVITY 1/

(Million Rupees)

Year	Total		Hotel Tourism		Power		Manufacturing		Miscellaneous	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1980/81	45.8	100.0	24.8	54.1	0.1	0.2	19.3	42.1	1.6	3.5
1981/82	30.8	100.0	16.8	54.5	-	0.0	10.1	32.8	3.9	12.7
1982/83	53.5	100.0	27.7	51.8	0.2	0.4	20.1	37.6	5.5	10.2
1983/84	41.4	100.0	21.1	51.0	0.2	0.5	15.7	37.9	4.4	10.6
1984/85	80.1	100.0	11.6	14.5	1.9	2.4	36.1	45.1	30.5	38.0
1985/86	117.0	100.0	26.9	23.0	0.6	0.5	75.1	64.2	14.4	12.3
1986/87	139.4	100.0	44.6	32.0	-	0.0	79.0	56.7	15.8	11.3
1987/88	157.2	100.0	21.5	13.7	8.3	5.3	101.6	64.6	25.8	16.4
1988/89	111.1	100.0	8.4	7.6	-	0.0	78.3	70.5	24.4	22.0
1989/90	167.4	100.0	29.1	17.4	0.5	0.3	109.4	65.4	28.4	17.0

1 Total of Short, Medium & Long term credits.

Table 9.8

COMMERCIAL BANKS LOANS BY TYPES OF ACTIVITY 1/

(Million Rupees)

Year	Total		Agriculture		Manufacturing		Commerce		Others	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
1980/81	3578.7	100.0	31.5	0.9	613.0	17.1	2001.1	55.9	933.1	26.1
1981/82	3140.5	100.0	57.6	1.8	313.2	10.0	1794.9	57.2	974.8	31.0
1982/83	3383.6	100.0	74.5	2.2	568.5	16.8	1529.0	45.2	1211.6	35.8
1983/84	3526.0	100.0	119.8	3.4	475.1	13.5	1652.4	46.9	1537.6	36.3
1984/85	4532.1	100.0	145.6	3.2	851.1	18.8	1997.8	44.1	1537.6	33.9
1985/86	5974.2	100.0	148.9	2.5	1736.8	29.1	2334.8	39.1	1753.7	29.4
1986/87	6941.5	100.0	153.2	2.2	2042.0	29.4	2476.8	35.7	2269.5	32.7
1987/88	8164.3	100.0	550.2	6.8	2575.2	31.5	2512.0	30.8	2523.9	30.9
1988/89	10356.7	100.0	1157.8	11.2	3134.7	30.3	2829.8	27.3	3234.4	31.2
1989/90	12117.2	100.0	1526.4	12.6	3814.0	31.5	3339.6	27.6	3437.2	28.4

1 Total of Short, Medium & Long term credits.

Table 9.9

BANK FINANCE IN AGRICULTURE AND MANUFACTURING SECTORS AS A PROPORTIONATE SHARE OF TOTAL BANK CREDITS

(Million Rupees)

Year	Total Bank Credit	Proportionate Share of Total Bank Credits (%)	
		Agriculture	Manufacturing
1980/81	3758.6	4.4	17.5
1981/82	3427.7	9.2	10.0
1982/83	3782.9	11.1	16.4
1983/84	4041.7	14.7	12.8
1984/85	5196.0	14.0	17.9
1985/86	6755.0	12.0	27.4
1986/87	7691.7	9.9	28.4
1987/88	9175.5	15.3	29.8
1988/89	11484.8	18.9	28.3
1989/90	13457.1	20.0	29.6

per cent in 1989/90. There was a considerable increase in manufacturing finance from 17.5 per cent to 29.6 per cent of the total investment during the review period.

1.3 Sources of Long-Term Financing

The financing needs of the agriculture sector is generally fulfilled by the Agricultural Development Bank and the Commercial banks. In 1980/81, Agricultural Development Bank's investment was Rs. 134.1 million, while that of commercial banks' was Rs. 31.5 million. But in 1989/90, the trend reversed and the commercial banks' investment in agriculture reached the level of Rs. 1,526.4 million, while that of Agricultural Development Bank's was Rs. 1,163.3 million.

In the manufacturing sector, the main sources of finance are Nepal Industries Development Corporation and Commercial Banks. In 1980/81, commercial banks' investment in manufacturing sector was in the tune Rs. 613.0 million and that of NIDC's was Rs. 45.8 million. In 1989/90, commercial banks' investment in the manufacturing sectors increased by more than 6 times and reached Rs. 3814.0 million, while NIDC's investments increased by 4 times and reached Rs. 167.4 million.

Agricultural Development Bank's sources of funds are share capital, reserves and surplus, public deposits, borrowings from Government, borrowings from Nepal Rastra Bank, borrowings from commercial banks, foreign borrowings, debentures issue and compulsory savings (Table 9.10). Nepal Industrial Development Corporation's sources of funds are share capital, reserves and surplus, borrowings from Government, borrowings from Nepal Rastra Bank, borrowings from commercial banks, foreign borrowings, and debentures issue (Table 9.11). Commercial banks' sources of funds are share capital, reserve funds, public deposits and borrowings from Nepal Rastra Bank (Table 9.12).

1.4 Lending Policies and Procedures

Agricultural Development Bank and Commercial Banks' investment policies in the agriculture sector are in line with the policies of the national development plan. The loan and investment policies of ADB and commercial banks are influenced by the Government's agriculture policy and the priorities set up by the development plan. The ADB has been acting as a major financier to implement the government's agriculture development programme.

The ADB and commercial banks provide agriculture loans for the following purposes:

Table 9.10

AGRICULTURAL DEVELOPMENT BANK
SOURCES OF FUND

(Million Rupees)

Year	Total	Capital & Reserve	Deposits	Borrowing From Nepal Rastra Bank	Foreign Borrowings	Others
1980/81	699.7	146.0	33.0	198.9	88.7	233.1
1981/82	838.0	158.5	37.0	222.0	167.4	253.1
1982/83	1011.9	173.9	35.2	236.1	246.4	320.3
1983/84	1296.7	196.2	37.9	332.2	333.7	396.7
1984/85	1676.5	224.0	104.5	414.6	456.8	476.6
1985/86	2171.3	254.0	199.3	487.9	631.2	598.9
1986/87	2586.9	263.6	321.0	493.0	837.7	671.6
1987/88	3142.4	266.1	541.0	461.6	1069.7	804.0
1988/89	3893.4	274.9	1104.1	347.3	1361.6	805.5
1989/90	4621.0	279.3	1742.2	322.3	1510.8	766.4

Table 9.11

NEPAL INDUSTRIAL DEVELOPMENT CORPORATION SOURCES OF FUND

(Million Rupees)

Year	Total	Capital & Reserve	Borrowing From Nepal Rastra Bank	Foreign Borrowings	Others
1980/81	407.8	168.9	119.5	60.5	58.9
1981/82	502.2	169.6	187.5 *	73.3	71.8
1982/83	560.8	194.6	175.5 *	84.9	105.8
1983/84	593.4	209.7	281.6 *	93.0	109.1
1984/85	656.3	221.6	217.6 *	68.0	148.9
1985/86	733.7	225.7	262.9 *	54.3	190.8
1986/87	821.8	248.8	292.5 *	99.2	181.3
1987/88	958.5	256.8	349.6 *	154.2	197.9
1988/89	1049.6	281.7	384.2 *	140.6	243.1
1989/90	1117.5	350.2	427.7 *	215.5	124.1

* Includes debenture issues.

Table 9.12

COMMERCIAL BANKS SOURCES OF FUND

(Million Rupees)

Year	Total	Capital & Reserve	Deposits	Borrowing From Nepal Rastra Bank	Others
1980/81	5987.7	83.0	4160.2	468.1	1276.4
1981/82	6257.4	93.0	4935.4	137.8	1091.2
1982/83	7735.2	104.5	6308.4	74.0	1248.3
1983/84	8565.4	137.2	7091.2	152.1	1184.9
1984/85	10678.5	151.6	8560.1	388.0	1578.8
1985/86	12876.8	183.1	10315.4	533.9	1844.4
1986/87	15289.2	224.2	11900.5	520.3	2644.2
1987/88	18887.7	254.9	14996.2	357.4	3279.2
1988/89	22611.1	285.2	19008.6	160.1	3157.2
1989/90	23360.4	311.6	20979.6	53.0	4216.2

i) To purchase fertiliser, tools, machineries, pumps, tractors and insecticides;

ii) To process agriculture products, and to produce agriculture implements;

iii) To establish agriculture and village industries;

iv) To purchase land from landlord by the tenants;

v) To run poultry farm, dairy farm, cattle farming and horticulture; and,

vi) Tea and coffee plantation.

Nepal Industrial Development Corporation (NIDC) and Commercial Banks' investment policies in the manufacturing sector are also in line with the policies of the national development plan. The loan and investment policies of the financial institutions are influenced by the Government's industrial policy and the priorities set up by the national development plan. NIDC, as a specialised agency in industrial finance, declares "NIDC will be guided by Government's National Economic Plan Industries in the Plan and will be promoted on a priority basis".

The financial institutions provide manufacturing loan for the following purposes:

i) To make available manufacturing credits to the entrepreneurs;

ii) Operation of hotels designated for development of tourism;

iii) Generation, transmission and distribution of electric power; and,

iv) Provision of means and facilities of transportation designated to develop industry and tourism.

Generally, the financial institution's procedures to finance agriculture and manufacturing sectors are as follows:

i) The person intended to seek loan should apply with a copy of citizenship, two copies of photo, copy of education certificate if any, copy of the certificate of property such as land or building to be pledged with the bank, a copy of proposed scheme, and the quotation of the goods or machinery to be purchased under financial institutions credit;

ii) If the loan applicant is an organisation, company or partnership firm, then such institution has to submit copy of registration, copies of prospectus and article of association, copy of recent balance - sheet, copy of auditor's report, copy of the resolution of the board of directors, name of the shareholders or partners to sign in the loan documents, a copy of project scheme, a copy of the project feasibility report;

iii) After receiving application, project scheme, project feasibility report and the necessary documents, the financial institution's official will visit the site or place of work. On the spot, site inspector has to take into consideration the following aspects:

   a. Whether the proposed scheme to secure the financial institution's loan is technically feasible or not and economically beneficial or not.

   b. The loan applicant and the member of the family are in a position to operate the project or not.

   c. The pledged properties such as land, building, machinery etc. are in accordance with the documents submitted or not.

   d. The inspection on the site should be done within 4 to 20 days of receiving the application according to the volume of loan.

   After studying the loan application proposal and the conduct of site inspection, the loan approval or rejection should be done within 7 to 30 days depending on the volume of loan.

iv) The next step is to take full security and to fill up the bond and signature specimen of the borrower;

v) The borrower is required to purchase certain shares of the financial institution (specially in the case of Agricultural Development Bank) depending on the volume of loan and has to pay a commitment charge;

vi) If the loan applicant is going to utilise the loan to purchase fertiliser or machinery or tools etc, then the bank will issue an order to the business firm concerned for delivery of the goods;

vii) The borrower will be given a pass book for the total amount of loan sanctioned and payments from time to time as per the need of the applicant;

viii) The financial institution will inspect from time to time on the site of the project to see whether the loan is utilised or not;

ix) If the loan is not utilised properly, the bank has to remind the borrower to utilise the loan. Even if the borrower failed to utilise the loan, the bank will have to proceed for further action to realise the loan;

Credit Guarantee Corporation (Pvt.) Ltd. was established in 1974 to guarantee the loans advanced by banks and financial institutions in the agriculture and industry to compensate the loss in case of default of such loans. In 1980/81, it had guaranteed the loans of Rs. 79.7 million and in 1989/90 Rs. 703.0 million.

II. The Role of Nepal Rastra Bank in Long-Term Financing for Manufacturing and Agricultural Sector

In a developing country like Nepal, Nepal Rastra Bank has to play an active role for the overall economic development of the country. Nepal Rastra Bank plays a vital role in mobilising resources through the development of financial institutions. For the overall development of the agriculture and manufacturing sectors of the country, Nepal Rastra Bank gives directives to the banks and financial institutions.

2.1 Financial Facilities from Nepal Rastra Bank

2.1.1 Contribution in Share Capital

For the past several years, Nepal Rastra Bank has been actively promoting the different financial and finance related development institutions. Nepal Rastra Bank directly participates in share capitals and debentures of Nepal Industrial Development Corporation (1959), Agriculture Development Bank (1967) and Rastriya Beema Sansthan (National Insurance Corporation - 1967). Similarly, Nepal Rastra Bank promoted and participated in share capitals of Agriculture Projects Services Centre (1974), Credit Guarantee Corporation (Pvt.) Ltd. (1974), and Credit Information Centre (1990).

2.1.2 Capital Market Developments

Nepal Rastra Bank and Nepal Industrial Development Corporation jointly promoted and financed Security Exchange Centre (1976) in order to develop the capital market in Nepal. This centre has created an internal market for Government bonds, public and private sector companies's shares and debentures.

2.1.3 Refinance Facilities

Nepal Rastra Bank refinanced ADB, NIDC and commercial banks to promote agriculture and industrial financing.

2.1.4 Productivity Sector Credit Programme

Nepal Rastra Bank gave directives to commercial banks to invest certain portion of their resources in productive sectors such as agriculture and manufacturing sectors. According to the directives of Nepal Rastra Bank, commercial banks' 40 per cent investment (12 per cent in priority sector) should be in the productive sector. If the bank failed to invest the desired amount in the productive sector, such an amount would have to be deposited with Nepal Rastra Bank without interest as a penalty. Nepal Rastra Bank also provides refinance facility to financial institutions for investment in productive sectors.

2.1.5 Cottage and Small Industry Project

Under joint co-operation with His Majesty's Government of Nepal, World Bank, and UNDP, the Cottage and Small Industry Project was launched in the fiscal year 1981/82. The World Bank had provided loan assistant of US $6.5 million to HMG Nepal initially. Nepal Rastra Bank has established a separate Project Office to inspect and supervise CSI Project. After the completion of the first phase of the programme, the second phase is launched with a long term credit of SDR 8.7 million from the World Bank. A total credit of Rs. 345.1 million was utilised under the CSI Project from its beginning to 1989/90. This programme has provided employment for nearly 50 thousand persons. This programme has been conducive to boosting the small scale industries to some extent and has also contributed to developing a few import substitution and export oriented industries.

2.2 Regulations

Nepal Rastra Bank, as the central bank of the country, issued regulations to the financial institutions from time to time to invest their resources in productive sectors. The main directives issued by Nepal Rastra Bank are as follows:

(1) Nepal Rastra Bank issued directive to commercial banks to invest certain portion of their resources in productive sectors such as agriculture and manufacturing sectors. According to the directives of Nepal Rastra Bank, commercial banks' 40 per cent investment (12 per cent in priority sector) should be in productive sector. If the bank failed to invest the desired amount in productive sector, such amount would have to be deposited with Nepal Rastra Bank with no interest as a penalty. This directive has been effective for promoting the investments of commercial banks in agriculture and manufacturing sectors. Between the periods of 1980/81 to 1989/90, the investment of commercial banks in the agricultural and manufacturing sectors had increased by nearly 49 times and 6 times respectively.

(2) Nepal Rastra Bank fixed a lower rate of interest on productive sector investment than on commercial loans to attract the entrepreneurs to invest in productive sector. Nepal Rastra Bank provides re-finance facility on priority sector investment up to 80 per cent of the loan to minimise the adverse effect in the profitability of commercial banks.

(3) Nepal Rastra Bank has issued directives to Credit Guarantee Corporation to guarantee the loan advanced by banks and financial institutions in priority sectors and to compensate the loss in case of default of such loans. It is believed that this facility has greatly encouraged the financial institutions to invest in priority sectors.

(4) The investment of commercial banks in priority sector is behind its target. The commercial banks insist more on collateral than on the feasibility of the project. In this way, the prospective entrepreneurs are discouraged. Hence, Nepal Rastra Bank issued directive to invest on feasible projects even on group guarantee in the event of a lack of individual collateral. This is one of the most practical step to boost productive sector loan in the country.

2.3 Supervision Problems

Nepal Rastra Bank, as a central bank of the country, is empowered to supervise and control banks and financial institutions. Nepal Rastra Bank's Inspection and Supervision Department is assigned to inspect and supervise financial institutions' head office and branches throughout the country from time to time. The inspection and supervision of financial institutions are carried out mainly to check the following aspects:

i) Whether the financial institutions follow the prevailing acts, rules and monetary policy for sound and healthy development of financial institutions or not?

ii) To regularise the directives given by Nepal Rastra Bank;

iii) To evaluate the management aspects and day to day functioning of the institutions;

iv) To evaluate the assets and liabilities of the institutions;

v) To study the institutions; contribution to the economic development of the country; and,

vi) To inspect bank finance project and to evaluate project's performance.

Nepal Rastra Bank is directly involved in analysing project proposals submitted by the borrowers and recommend loans only in the case of CSI Project loan under the World Bank, UNDP and HMG programme.

2.4 Implications for Nepal Rastra Bank

Nepal Rastra Bank gives full liberty to banks and financial institutions to invest their resources except for general guidance to invest certain percentage of their investment in productive sector as determined by the development plan. Nepal Rastra Bank is not involved in project analysis and sanctioning of loans, so there is no question of delay due to Nepal Rastra Bank's interference. Nepal Rastra Bank is only responsible for overseeing that the institutions have utilised properly their resources and to ensure timely repayment of loans. Nepal Rastra Bank is represented in most of the financial institutions' Board to formulate and provide guidelines, policy, programme, and targets regarding investment and loan recovery. In this way, Nepal Rastra Bank is involved directly and indirectly in the financial institutions' activities for effective utilisation of funds.

III. Issues and Suggestions in Long-Term Financing for Manufacturing and Agricultural Sectors

3.1 Factors Limiting Access to Institutional Credit

The long term financing of the manufacturing sector is concentrated in some of the urban areas of the country. It is mainly due to the availability of physical infrastructures, skilled manpower from across the boarder and markets. In the case of agriculture finance, its coverage is wider than the industrial finance. NIDC is operating in limited scale with 5 offices and 2 liaison offices, while ADB is expanding rapidly with 218 branches and staff strength of 4162. NIDC's sources of funds are limited to share capital, Nepal Rastra Bank's refinance facilities, debentures and foreign borrowings. But that of ADB's sources of funds are share capital, Nepal Rastra Bank's refinance facilities, foreign borrowings and public deposits. ADB is providing general banking services in some of the branches specially in the Kathmandu valley and have been successful in mobilising savings for investment. In the fiscal year 1989/90, the public deposits liabilities of ADB was Rs. 1,742 million and is currently the biggest source of fund for ADB's investment.

The commercial banks' investment in the agriculture and manufacturing sectors have surpassed the investments of the specialised agencies such as the ADB and NIDC. The terms structure of lending information on agriculture and manufacturing sectors investments of commercial banks are not available, so it is difficult to measure the actual growth rate of long-term investments of commercial banks in Nepal.

Despite a modest effort from the financial institutions to enhance their investments in agriculture and manufacturing, the present level of their investment is found to be inadequate, which has been revealed from the growth of these sectors as measured by GDP.

The lending procedures of financial institutions are very lengthy and time consuming, such that the entrepreneurs with sketchy ideas on project proposals are hesitant to approach the financial institutions for loan. Even the bank staffs are not co-operative toward the borrowers and much too rigid in formalities for lending. The borrowers are not aware of government programmes and bank schemes due to poor transport and communication facilities.

3.2 Repayment Policy and Problems

The repayment policies and procedures differ from one loan to another. Some examples of repayments of loans according to the nature of loan are given below:

i) *Modern Cold Storage*

Grace period of one year and period of repayment 15 years on half yearly basis or yearly installment basis.

ii) *Land Development Loan*

No grace period and time period of repayment is 11 years on yearly installment basis.

iii) *Tree Plantation*

Grace period of 5 years and time period of repayment is 15 years on yearly installment basis.

There are many cases of loan defaults and delinquency in the investment of banks and financial institutions in the productive sector. The major causes of defaults are:

i) In Nepal, agriculture is mostly dependent on monsoon rain, so there is uncertainty in the agricultural production. In this situation, the borrowers' capability to repay loan depends on the weather conditions. There are many cases of loan defaults in the agriculture sector.

ii) In Nepal, to venture into the manufacturing sector is a challenging one, since the entrepreneurs have to import raw materials, machineries, and even skilled manpower to operate the machines. The markets for manufactured products are also scattered and most of the areas are inaccessible due to a lack of transport facilities. Lastly, there is a tough competition from Indian products, since the industrial protection measures of the Government is ineffective due to an open border of 500 miles with India. There are many cases of failures of industrial ventures financed by banks.

iii) The bank officials' irresponsible behaviour are also the cause of loan defaults in many cases.

iv) In the past Government used to change frequently the industrial and agricultural policies which are also responsible for loan defaults.

In 1990, as a part of financial reform, HMG Nepal made a budgetary provision of Rs. 3,092 million for strengthening and standardising the banking sector. It is hoped that most of the amount in the budgetary provision will be utilised to clear the government dues with the commercial banks and other financial institutions. This will certainly help to improve the financial position of the banking institutions.

3.3 Future Needs of Long-Term Financing

The future needs of long-term financing for the agricultural and industrial sectors are expected to increase continuously.

The future needs for agricultural financing will increase to finance tenants to purchase lands from landlords; to improve lands' productivity by introducing the irrigation system, use of fertilisers, insecticides and modern agricultural tools and tractors and means of agriculture products' transportations etc.

The manufacturing sector's financial need will also increase due to gradual development of manufacturing sector in the country.

3.4 Recommendations for Further Improvements

The problems faced by the borrowers/lenders in obtaining/providing loans for productive sectors have been identify as follows:

(1) The borrowers faced problem in getting bank loans, since they themselves could not prepare the project proposal.

(2) Registration of Industry and loan application process are time consuming and lengthy.

(3) The responsibility and sense of duty on the part of the bank staff are very low, and are often non responsive to the borrowers. The borrowers have to visit many times to get the loan sanctioned.

(4) The existing rules and regulations are very rigid, so the prospective borrowers are discouraged to take loan from the bank.

(5) The suppliers of necessary machineries in the country are limited, the borrowers have to visit importing country to ascertain the technology to be imported and to take quotations.

(6) There are shortages of trained staffs in the bank branches to appraise the project proposal, so only a few selected bank branches are providing loans for productive sectors.

On the background of the existing Government policies, bank regulation and performance of the financial institutions, the following suggestions are made to improve the existing conditions:

(1) First of all, HMG Nepal should formulate stable industrial and agricultural policies for the development of both the agricultural and manufacturing sectors in the country.

(2) The loan procedures of the financial institutions should be simplified. It is not practical to impose the same procedure for both the small and big borrowers. It would be practical to form a simpler procedure for small borrowers.

(3) The job description of the staff of all the financial institutions should be fully defined. There should be some well defined administrative system to provide a reward or punishment to boost the moral of the staff.

(4) The financial institutions in the country should impart quick and quality services to their customers.

(5) The employees representative should be represented on the board to have a voice in management.

(6) The employees have to be encouraged to purchase shares of their working financial institutions.

IV. Major Findings and Concluding Remarks

The history of the modern banking development in Nepal is very short. The first public limited bank was established just five decades ago. Since then there has been a gradual development of financial institutions including specialised agencies for financing agriculture and industry. The geographical location of the country has been a major obstacle for economic growth. The major findings of the study are as follows:

(1) The financial institutions' investments are mainly concentrated in some urban and rural centres.

(2) The sense of duty and responsibility among the staff of the financial institutions are deplorable. As such in loan processing the staff only seek to fulfill the legal formalities rather than the viability to sanction the loan. In this situation, the real entrepreneurs are always discouraged to borrow institutional loans. The financial institutions' staff moral should be boosted so that they would take appropriate responsibility on their own and encourage the genuine borrowers.

(3) Generally, the financial institutions are the only source of employment generation. Over staffing has been almost a common phenomenon, which has created an adverse impact on the profitability of these institutions. This situation should be controlled. There should be manpower planning in each

institution and to re-organise the existing manpower on a structured plan.

(4) Over staffing is found mostly on the clerical level while there is an acute shortage of technical staffs. Due to the lack of technical staff, only selected branches of the financial institutions are providing long term credits for the productive sector. It will be beneficial to establish the Institute of Banking under Tribhuvan University in Nepal to fulfill the rising demand for trained man power in the banking sector.

(5) The specialised agency, Nepal Industrial Development Corporation, which has been established some three decades ago for the development of manufacturing sector has not been able to discharge its duty satisfactorily. The activities of NIDC are still concentrated in a few urban centres of the country. It has to expand its branches in all urban centres and in selected rural areas. It is also not able to mobilise resources for financing. During the period of 10 years, its investments have increased four times only. It has to establish relation with multi national financial institutions for joint financing in large scale industries and to guarantee borrowers for securing loans from the international financial institutions.

(6) Agricultural Development Bank being a specialised agency in agriculture finance has a greater role to play in Nepal, since it is predominantly an agriculture country. There are still scope for expanding its branches in the rural area with general bank services. It will have twofold effects in rural development. First, the bank can mobilise resources for local development and secondly, it can provide banking services in the remote areas of the country.

(7) An alternative source of agriculture and manufacturing financing is from the commercial banks. Nepal Rastra Bank has to further encourage these institutions to invest in core sectors of agriculture and industry and to limit its operation on consumption loans.

(8) Commercial banks have to employ more technical personnel to provide specialized services needed to expand its productive sector loan investment in agriculture and manufacturing.

In Nepal, Agricultural Development Bank, Nepal Industrial Development Corporation and commercial banks are the only institutions involved in the agriculture and manufacturing sectors financing. However, the contribution of these institutions to the overall development of the two sectors is not satisfactory. The slow growth of the targetted sectors in the past was partly due to inefficient management and partly to instable agriculture and industrial policy of the then Government. Moreover, inadequate infrastructural facilities has also been responsible for the slow pace of growth in agriculture and industry.

Chapter 10

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THE PHILIPPINES

by

Antonio B. Cintura and Agnes M. Yap

I. An Overview of the Existing Conditions of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Nature of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1.1 Definitions and Scope

Long-term financing in this paper is defined as loans and credit extended by the financial system with maturities of more than five years. Definitions of the manufacturing and agricultural sectors follow the classification of the Philippine Standard Industrial Classification [1]. The Philippine financial system is composed of banks and non-banking financial institutions. Banks include commercial banks (universal banks and regular commercial banks), thrift banks (savings banks, development banks, and stock savings and loan associations), specialized government banks, and rural banks. Non-bank financial institutions include investment houses, financing companies, pawnshops, lending investors, and other types of financial institutions that extend credit and borrow funds from the public other than through deposit-taking.

Due to the scarcity of data, this paper is limited to outstanding financing granted by commercial banks, savings banks, and specialized government banks (except those granted by the Development Bank of the Philippines where comparable data are not available). These banks comprise about 70 per cent of the resources of the financial system as of 1990 and about 90 per cent of the resources of the banking system

1 The agricultural sector includes the agriculture, fisheries and forestry sub-sectors.

as of the same year. Most discussions, however, will focus on the operations of commercial banks.

Unless otherwise specified, the term financing shall mean outstanding loans and credits granted by banks and other financial institutions. Supplemental (but incomplete and/or non-comparable) data from banks other than commercial, savings, and specialized government banks and from other non-bank financial institutions are also included to help support a trend, confirm an observation or provide additional information.

This paper covers the period from 1980 to 1990.

1.1.2 Overview

In the process of industrialization among developing economies such as the SEACEN countries, the magnitude and pace of growth of the manufacturing and agricultural sectors are considered as key indicators of these countries' stage of economic development. In providing vital infrastructure and technology for these sectors, long-term financing is needed. Government regulations affecting long-term financing for these two sectors are, therefore, regarded as important policy instruments for stimulating economic growth.

In the Philippines, the manufacturing and agricultural sectors had reached a point of convergence in terms of essentially equal shares in the country's gross domestic product (GDP) in 1980-1990 (Tables 10.1 and 10.2). Although the manufacturing sector had an overall edge in sectoral shares in real GDP (25.8 per cent against 23.4 per cent in agriculture), it posted a slightly lower average real growth rate during the same period (1.1 per cent against 1.2 per cent in the agricultural sector) (Tables 10.3). In nominal terms, however, the manufacturing sector maintained a higher average growth rate of 16.0 per cent compared to 15.2 per cent in the agricultural sector (Table 10.4). It may be noted that both sectors suffered contractions in real growth in 1983-1985, largely as a result of the foreign exchange and financial crisis in the country during that period. It was not until 1987 that these sectors started to recover, and the manufacturing sector overtook the agricultural sector in terms of real sectoral growth. In general, however, both sectors experienced an overall slowdown during the period. This general downtrend may be partly explained by the magnitude and growth of long-term financing provided by the country's financial system during that period.

The magnitude and growth of long-term financing in the Philippines has been very limited. While most financial institutions engage in this type of lending, the total amount involved has remained minimal compared to other forms of financing. Available data indicate that long-term financing averaged only about 11 per cent of total outstanding

Table 10.1

SECTORAL SHARES IN REAL GDP 1/
1980-1990

(In Per Cent)

Sector	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	23.5	23.5	22.9	21.7	23.2	24.6	24.6	24.3	23.6	22.9	22.4	23.4
Industry	40.5	41.0	40.5	40.4	38.6	35.1	34.7	34.9	35.3	36.0	36.0	37.5
of which: Manufacturing	27.6	27.2	26.7	26.1	25.3	25.2	24.8	24.9	25.5	25.5	25.6	25.9
Services	36.0	35.5	36.6	37.9	38.2	40.3	40.7	40.8	41.1	41.1	41.6	39.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

1/ At constant 1985 prices; as of February 1993.

Source of basic data: Economic and Social Statistics Office, National Statistical Coordination Board.

Table 10.2

SECTORAL SHARES IN NOMINAL GDP 1980-1990

(In Per Cent)

Sector	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	25.1	24.9	23.3	22.4	24.8	24.6	23.9	23.9	22.9	22.5	22.0	23.7
Industry	38.8	39.2	38.8	39.2	37.9	35.1	34.6	34.7	35.5	35.5	34.9	36.7
of which: Manufacturing	25.7	25.5	25.1	24.2	24.6	25.2	24.6	24.8	25.8	25.3	25.0	25.1
Services	36.1	35.9	37.9	38.4	37.3	40.3	41.5	41.4	41.6	42.0	43.1	39.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source of basic data: Economic and Social Statistics Office, National Statistical Coordination Board.

Table 10.3

REAL SECTORAL GROWTHS, 1981-1990

(In Per Cent)

Sector	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	3.6	0.8	-3.4	-0.9	-1.9	3.7	3.2	3.2	3.0	0.5	1.2
Industry	4.6	2.5	1.5	-11.5	-15.7	2.3	5.4	7.6	8.2	2.6	0.8
of which: Manufacturing	1.9	1.6	-0.3	-10.1	-7.9	1.8	5.6	8.5	6.4	3.1	1.1
Services	1.9	6.8	5.6	-6.5	-2.1	4.2	5.2	6.9	6.0	4.0	3.2

Source of basic data: Economic and Social Statistics Office, National Statistical

Table 10.4

NOMINAL SECTORAL GROWTHS, 1981-1990

(In Per Cent)

Sector	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	14.5	5.7	11.5	57.3	8.3	3.7	12.4	11.9	14.4	12.4	15.2
Industry	16.7	11.6	17.6	37.3	0.8	5.3	12.9	19.8	14.8	13.9	15.1
of which:											
Manufacturing	14.6	10.8	12.4	44.4	11.2	4.6	13.4	21.6	12.5	14.7	16.0
Services	15.0	18.6	18.1	38.2	17.8	9.4	12.4	17.7	16.0	19.1	18.2

Source of basic data: Economic and Social Statistics Office, National Statistical Coordination Board.

financing in 1980-1990 (Table 10.5, average of column C/F). During the same period, long-term financing grew at an annual average rate of 2.6 per cent compared to the 12.5 per cent annual average growth posted by total financing.

A similar trend was observed during the same period on the part of commercial banks, which provided the bulk of formal financing in the country, but on a lower average proportion to total financing of 9.6 per cent (Table 10.6). During the period, commercial banks alloted a declining portion of their total loanable funds to long-term financing (from 13.0 per cent in 1980 to 3.3 per cent in 1990).

Moreover, while commercial banks alloted the bulk (average of 40 per cent) of their total funds to the manufacturing sector (Table 10.7), long-term funds channelled to the same sector amounted to an average of only 23.7 per cent, and had gone down to as low as 10.8 per cent in 1989 (Table 10.8). A smaller, though more stable, portion (average of 10 per cent) of commercial banks' long-term funds had been channelled to agriculture. This could explain the overall positive growth in total long-term financing in agriculture as contrasted to an average decline in manufacturing financing during the same period.

1.1.3 General Trends

During the period 1980-1990, long-term financing in the agricultural and manufacturing sectors averaged 11.4 per cent and 6.6 per

Table 10.5

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS, 1980-1990 1/

(In Million Pesos; Per Cent)

YEAR	Long-Term Financing			Total Financing			A/D	B/E	C/F
	Agricultural Sector (A)	Manufacturing Sector (B)	All Sectors (C)	Agricultural Sector (D)	Manufacturing Sector (E)	All Sectors (F)			
1980	1,072	2,796	12,398	13,198	29,349	81,518	8.1	9.5	15.2
	(8.6)	(22.6)		(16.2)	(36.0)				
1981 a/	1,245	2,302	12,446	13,342	28,316	95,893	9.3	8.1	13.0
	(10.0)	(18.5)		(13.9)	(29.5)				
1982	1,979	3,806	14,888	14,298	32,641	105,529	13.8	11.7	14.1
	(13.3)	(25.6)		(13.5)	(30.9)				
1983 b/	1,660	1,620	8,712	9,850	28,168	78,844	16.9	5.8	11.0
	(19.1)	(18.6)		(12.5)	(35.7)				
1984	1,013	1,744	9,449	8,414	29,693	79,882	12.0	5.9	11.8
	(10.7)	(18.5)		(10.5)	(37.2)				
1985	1,440	1,770	7,086	7,999	19,567	60,563	18.0	9.0	11.7
	(20.3)	(25.0)		(13.2)	(32.3)				
1986	833	2,392	9,286	9,024	20,345	61,382	9.2	11.8	15.1
	(9.0)	(25.8)		(14.7)	(33.1)				
1987	633	1,593	6,783	7,986	39,123	83,618	7.9	4.1	8.1
	(9.3)	(23.5)		(9.6)	(46.8)				
1988	1,038	1,670	11,214	9,856	49,265	107,292	10.5	3.4	10.5
	(9.3)	(14.9)		(9.2)	(45.9)				
1989	1,567	1,251	11,786	11,458	68,000	150,489	13.7	1.8	7.8
	(13.3)	(10.6)		(7.6)	(45.2)				
1990	975	1,103	10,511	17,204	88,550	209,413	5.7	1.2	5.0
	(9.3)	(10.5)		(8.2)	(42.3)				
Average annual rate of increase 1981-1990	7.3	-3.1	2.6	4.9	16.0	12.5			

Note: Figures in parentheses represent the share of that sector in the all sector total.

1 Represents loans outstanding of commercial banks, savings banks, and specialized government banks (except the Development Bank of the Philippines) with maturities of over five years.

a/ Based on first quarter 1982 figures

b/ Based on first quarter 1984 figures

Source: Department of Economic Research-Domestic, Central Bank of the Philippines.

Table 10.6

LOANS OUTSTANDING OF COMMERCIAL BANKS, BY MATURITY, 1980-1990

(Per Cent Distribution)

	1980	1981 a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
Demand	12.6	12.6	9.5	14.5	7.6	9.0	10.3	20.9	16.8	19.1	17.9	13.7
Short-term	63.8	61.1	59.5	62.2	61.2	64.2	60.9	56.2	59.2	57.0	62.5	60.7
Medium-term	10.6	15.8	18.1	14.7	21.5	16.6	15.4	15.9	14.0	16.8	16.3	16.0
Long-term	13.0	10.5	12.9	8.6	9.7	10.2	13.4	7.0	10.0	7.1	3.3	9.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

a/ Based on 1st quarter 1982 data.
b/ Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

cent, respectively, of their corresponding total sectoral financing levels (Table 10.5, average of columns A/D and B/E). While long-term financing in the agricultural sector grew at an annual average rate of 7.3 per cent, long-term financing in the manufacturing sector declined at an annual average rate of 3.1 per cent during the same period.

The combined long-term agricultural and manufacturing financing level had steadily decreased as a proportion of the country's GDP from 1.6 per cent in 1980 to 0.2 per cent in 1990 or an average ratio of 0.8 per cent (Table 10.9). The same trends were observed in the ratios of the combined long-term financing in agricultural and manufacturing sectors to total exports and value-added levels, which decelerated from 8.9 per cent to 1.0 per cent (average of 4.8 per cent), and from 3.1 per cent to 0.4 per cent (average of 1.5 per cent), respectively, during the same period.

While exports of the whole agricultural sector recorded a similar decreasing ratio from 42.5 per cent of total exports in 1980 to 18.2 per cent in 1990 (or an average of 30.5 per cent), exports in the whole manufacturing sector indicated an increasing trend from 34.5 per cent

Table 10.7

TOTAL LOANS OUTSTANDING OF COMMERCIAL BANKS, BY ECONOMIC ACTIVITY, 1980-1990

(Per Cent Distribution)

Economic Activity	1980	1981 a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	15.5	12.9	13.4	11.9	10.0	12.7	14.8	9.2	7.4	7.2	7.8	11.2
Mining and quarrying	9.0	8.8	10.0	6.4	10.3	6.3	4.1	3.0	2.5	5.6	8.6	6.8
Manufacturing	39.5	32.0	33.0	39.2	40.5	34.4	35.7	48.7	47.3	45.6	43.6	40.0
Electricity, gas, and water	1.1	1.3	1.1	0.8	2.0	1.1	1.5	0.8	0.8	0.8	0.4	1.1
Construction	3.2	5.1	5.2	3.1	3.4	2.9	1.9	2.3	2.3	1.7	2.3	3.0
Wholesale and retail trade	10.1	15.4	13.6	11.1	9.8	11.0	14.2	13.4	16.7	14.3	17.0	13.3
Transportation, storage, and communication	3.0	3.4	3.5	3.3	3.9	3.5	3.6	2.9	2.6	4.1	3.6	3.4
Financial, insurance, real estate and business services	13.5	16.1	15.1	19.2	16.5	21.5	19.4	14.6	14.2	13.5	12.0	16.0
Commercial, social, and personal services	5.1	5.0	5.1	5.0	3.6	6.6	4.8	5.1	6.1	7.2	4.7	5.3
T o t a l	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	99.9	100.0	100.0	100.0

a/ Based on 1st quarter 1982 data.

b/ Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.8

LONG-TERM FINANCING OF COMMERCIAL BANKS, BY ECONOMIC ACTIVITY, 1980-1990

(Per Cent Distribution)

Economic Activity	1980	1981 a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
Agriculture, fishery, and forestry	4.0	6.4	12.0	19.7	8.2	18.7	5.7	5.5	7.8	12.6	9.1	10.0
Mining and quarrying	25.0	10.5	12.8	14.8	19.9	17.9	12.8	16.6	12.5	11.1	14.7	15.3
Manufacturing	28.7	24.4	29.6	25.9	23.2	29.7	30.2	28.8	15.8	10.8	13.8	23.7
Electricity, gas, and water	5.6	2.0	1.5	0.1	0.2	0.0	4.5	0.0	0.9	1.0	1.5	1.6
Construction	1.7	14.5	12.5	2.4	4.0	2.3	2.4	6.5	2.7	4.0	8.1	5.6
Wholesale and retail trade	2.2	0.6	0.8	3.1	2.8	5.7	2.5	1.4	5.7	0.9	4.2	2.7
Transportation, storage, and communication	8.0	7.3	8.8	2.4	9.0	13.0	11.3	12.5	9.2	9.7	12.8	9.4
Financial, insurance, real estate and business services	9.3	16.8	10.8	30.6	31.3	11.5	30.1	24.6	32.5	43.7	24.8	24.2
Commercial, social, and personal services	15.5	17.5	11.2	1.0	1.4	1.2	0.5	4.1	12.9	6.2	11.0	7.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

a/ Based on 1st quarter 1982 data.

b/ Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.9

RATIO OF LONG-TERM FINANCING FOR THE MANUFACTURING AND AGRICULTURAL SECTORS TO GROSS DOMESTIC PRODUCT, TOTAL EXPORTS AND VALUE ADDED IN THE MANUFACTURING AND AGRICULTURAL SECTORS, 1980-1990

(In Million Pesos; Per Cent)

YEAR	Total Long-Term Financing for the Manufacturing and Agricultural Sectors 1/ (A)	Gross Domestic Product (B)	Total Exports (C)	Value Added in the Manufacturing and Agricultural Sectors (D)	A/B	A/C	A/D
1980	3,868	243,749	43,476	123,873	1.6	8.9	3.1
1981 a/	3,547	281,596	45,202	141,921	1.3	7.8	2.5
1982	5,785	317,177	42,879	153,663	1.8	13.5	3.8
1983 b/	3,280	369,077	55,619	172,017	0.9	5.9	1.9
1984	2,757	524,481	90,023	258,995	0.5	3.1	1.1
1985	3,210	571,883	86,133	284,405	0.6	3.7	1.1
1986	3,225	608,887	98,707	295,765	0.5	3.3	1.1
1987	2,226	685,068	117,647	333,554	0.3	1.9	0.7
1988	2,708	802,519	149,224	390,243	0.3	1.8	0.7
1989	2,818	925,161	170,003	443,201	0.3	1.7	0.6
1990	2,078	1,070,900	199,006	503,441	0.2	1.0	0.4

1 Represents loans outstanding of commercial banks, savings banks, and specialized government banks (except the Development Bank of the Philippines) with maturities of over five years.

a/ Based on 1st quarter 1982 data.

b/ Based on 1st quarter 1984 data.

Source: DER-Domestic and DER-International, Central Bank of the Philippines.

of total exports in 1980 to 69.7 per cent in 1990 (or an average of 53.6 per cent) (Table 10.10). During the same period, total exports in the manufacturing sector grew at an annual average rate of 11.7 per cent, higher than the 4.2 per cent annual average growth rate in total exports. On the other hand, agricultural exports declined at an annual average rate of 4.3 per cent during the same period.

Table 10.10

CONTRIBUTION OF THE AGRICULTURAL AND MANUFACTURING SECTORS TO EXPORTS, 1980-1990 1/

(In Per Cent)

YEAR	Share to Total Exports		Rate of Increase in Exports						
	Agricultural Sector	Manufacturing Sector	Total 2/	Agricultural Sector		Manufacturing Sector		Other Sectors	
1980	42.5	34.5							
1981	38.9	41.4	-1.1	-9.4	(-3.8)	18.7	(6.2)	-15.7	(-3.5)
1982	36.7	47.3	-12.3	-17.3	(-6.8)	0.2	(0.1)	-28.4	(-5.6)
1983	35.5	47.1	-0.3	-3.5	(-1.2)	-0.7	(-0.3)	8.0	(1.2)
1984	33.3	51.5	7.7	0.9	(0.3)	17.7	(8.3)	-5.5	(-0.9)
1985	29.7	54.8	-14.1	-23.3	(-7.7)	-8.5	(-4.4)	-13.2	(-2.0)
1986	29.3	55.2	4.6	2.9	(0.9)	5.2	(2.8)	5.6	(0.9)
1987	26.9	60.0	18.1	8.6	(2.5)	28.4	(15.6)	-0.3	(—)
1988	24.1	61.3	23.7	10.7	(2.9)	26.5	(15.9)	37.5	(4.9)
1989	20.8	66.4	10.6	-4.6	(-1.1)	19.7	(12.1)	-2.7	(-0.4)
1990	18.2	69.7	4.7	-8.4	(-1.7)	9.9	(6.6)	-1.3	(-0.2)
Average	30.5	53.6	4.2	-4.3	(-1.6)	11.7	(6.3)	-1.6	(-0.5)

Note: Figures in parentheses represent sectoral contributions to the overall rate of increase in exports.

1 Total exports are classified by major commodity groups, i.e., coconut products, sugar & products, fruits and vegetables, other agro-based products, forest products, mineral products, petroleum products, and manufactures. Exports of the agricultural sector cover exports of the first five commodity groups and exports of the manufacturing sector include exports of manufactures.

2 Based on dollar value.

— Less than 0.1 percent.

Sources: DER-Domestic and DER-International, Central Bank of the Philippines;. National Statistical Coordination Board.

In terms of job generation, both sectors had decelerating contributions to employment during the period under review. The agricultural sector's share to total employment had declined from 51.4 per cent in 1980 to 44.3 per cent in 1990; while the manufacturing sector's share had decreased from 11.0 per cent in 1980 to 9.9 per cent in 1990 (Table 10.11). Of the average annual growth rate of 3.3 per cent in employment during 1980-1990, the agricultural sector contributed 0.7 percentage point while the manufacturing sector accounted for 0.2 percentage point of the overall growth.

1.1.4 Commercial Bank Financing by Product

Long-term financing in agriculture by commercial banks in terms of product breakdown was concentrated on agricultural crops and services, with share to total financing ranging from 67 per cent to 98 per cent during the period 1980-1990 (Table 10.12). The more significant products funded were sugarcane, coconut, fruits, livestock, and

Table 10.11

CONTRIBUTION OF THE AGRICULTURAL AND MANUFACTURING SECTORS TO EMPLOYMENT, 1980-1990

(In Per Cent)

YEAR	Share to Total Employment		Rate of Increase in Employment 1/						
	Agricultural Sector	Manufacturing Sector	Total	Agricultural Sector		Manufacturing Sector		Other Sectors	
1980	51.4	11.0							
1981	51.2	10.4	6.2	5.6	(2.9)	-0.4	(-0.1)	8.9	(3.4)
1982	53.3	10.4	-4.1	-0.1	(0.0)	-3.7	(-0.4)	-9.6	(-3.7)
1983	53.3	10.2	10.8	10.8	(5.7)	8.4	(0.9)	11.6	(4.2)
1984	51.5	10.3	0.0	-3.3	(-4.8)	1.0	(0.3)	4.6	(4.5)
1985	39.5	8.9	2.2	-21.5	(-10.8)	-11.9	(-1.2)	38.0	(14.2)
1986	51.9	9.8	3.5	35.9	(14.2)	14.2	(1.3)	-23.2	(-12.0)
1987	48.9	9.8	5.9	-0.4	(0.0)	6.6	(0.6)	14.3	(5.3)
1988	46.4	10.2	3.4	-1.9	(-1.0)	6.7	(0.7)	8.8	(3.7)
1989	45.3	10.6	1.6	-0.7	(-0.3)	6.1	(0.6)	3.0	(1.3)
1990	44.3	9.9	3.1	0.8	(0.3)	-3.5	(-0.3)	7.1	(3.1)
Average	48.8	10.1	3.3	2.5	(0.7)	2.4	(0.2)	6.4	(2.4)

1 Figures in parentheses represent sectoral contributions to the overall rate of increase in employment.

Sources: DER-Domestic, Central Bank of the Philippines; Department of Labor and Employment.

Table 10.12

LONG-TERM FINANCING IN AGRICULTURE OF COMMERCIAL BANKS BY PRODUCT, 1980-1990 1/

(Per Cent Distribution)

Product	1980	1981a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
A. Agricultural crops & services	90.1	97.0	98.0	92.4	85.7	89.5	94.5	66.9	86.5	93.9	77.9	88.4
1. Abaca	-	-	-	-	-	-	-	-	-	-	-	-
2. Coconut	0.3	0.9	0.1	0.0	1.8	4.6	0.2	35.7	63.0	81.6	0.0	17.1
3. Corn	0.0	5.9	0.0	-	12.9	15.5	-	-	-	-	-	3.1
4. Fiber crops	-	-	-	-	-	-	-	-	-	-	-	-
5. Fruits & nuts	0.4	7.1	7.5	5.5	0.7	4.3	0.1	3.9	0.3	-	27.7	5.2
of which: banana	-	-	-	0.1	-	-	-	-	0.0	-	27.7	2.5
6. Palay	0.4	0.5	0.3	0.0	-	0.0	4.6	0.1	0.1	2.0	-	0.7
7. Sugar cane	71.9	45.9	46.4	1.4	0.1	0.0	0.0	16.6	18.9	9.8	42.0	23.0
8. Tobacco	0.1	-	-	-	-	-	-	-	-	-	-	-
9. Vegetables	0.2	0.3	0.2	7.4	25.0	14.2	0.4	0.6	0.2	-	-	4.4
10. Other agricultural crops, nec	0.0	4.0	0.5	0.1	10.9	7.6	10.9	9.4	2.4	-	-	4.2
11. Livestock & livestock products	5.4	2.1	9.7	12.6	10.5	13.5	62.3	0.1	0.5	0.4	1.6	10.8
12. Poultry & poultry products	10.5	20.5	6.0	2.3	-	17.6	0.5	0.6	0.4	0.1	3.3	5.6
13. Raising of other animals	-	-	0.4	-	-	0.4	-	-	0.3	-	1.8	0.3
14. Agricultural services	0.9	9.8	26.9	63.0	23.8	11.9	15.5	0.0	0.4	-	1.5	14.0
B. Fishery	0.1	1.0	0.1	7.3	14.0	8.4	1.6	27.5	10.9	3.5	22.1	8.8
1. Island fishing	0.0	0.0	0.0	7.2	14.0	8.4	-	0.6	0.2	0.2	0.2	2.8
2. Ocean (offshore) & coastal fishing	-	0.8	-	-	-	-	-	-	0.1	-	1.6	0.2
3. Operation of fish farms	0.1	0.1	0.1	0.1	-	-	1.3	8.5	7.2	1.4	14.1	3.0
4. Other fishing activities	-	0.0	0.0	-	-	0.1	0.3	18.4	3.3	1.9	6.2	2.7
C. Forestry	9.8	2.0	1.9	0.3	0.3	.1	3.9	5.6	2.6	2.6	-	2.8
1. Logging	7.7	2.0	1.9	0.3	0.3	2.1	3.9	5.6	2.6	2.6	-	2.6
2. Forest nurseries	-	-	-	-	-	-	-	-	-	-	-	-
3. Forestry services	-	-	-	-	-	-	-	-	-	-	-	-
4. Gathering of uncultivated food products	-	-	-	-	-	-	-	-	-	-	-	-
5. Timber tracts, planting & replanting	-	-	0.0	-	-	-	-	-	-	-	-	-
6. Other forest activities	2.1	0.0	-	-	-	-	-	-	-	-	-	0.2
D. Hunting, trapping & game propagation	-	-	-	-	-	-	-	-	-	-	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	

1 As of end-1990, commercial banks supplied around 59 percent of the aggregate long-term financing for the agricultural sector.
– less than 0.1 percent
a Based on 1st quarter 1982 data
b Based on 1st quarter 1984 data

Source: DER-Domestic, Central Bank of the Philippines.

poultry. Agricultural services received significant amounts in 1981-1986, after which starting in 1987, substantial amounts were shifted to coconut and fishery, particularly in the operation of fish farms. Meanwhile, funds channelled to forestry activities remained minimal. As of 1990, the major agricultural products funded by long-term financing by commercial banks were sugarcane (42 per cent), fruits and nuts (28 per cent), and operation of fish farms (14 per cent). As can be noted, these products are also sources of the country's major agricultural exports such as sugar, bananas, and shrimps (Table 10.13).

Table 10.13

MAIN EXPORTS AND IMPORT COMMODITIES
(Selected Years)

YEAR	Main Export Commodities	Main Import Commodities
1980	Sugar (centrifugal & refined), coconut oil, copper concentrates, semi-conductor devices	Mineral fuels, lubricants & related materials, machinery other than electric, materials for the manufacture of electrical & electronic machinery, transport equipment.
1982	Semi-conductor devices, sugar, coconut oil, copper concentrates	Mineral fuels, lubricants & related materials, machinery other than electric, materials & accessories for the manufacture of electrical equipment, base metals.
1984	Semi-conductor devices, coconut oil, electronic microcircuits, sugar	Mineral fuels, lubricants & related materials, special transactions & commodities not classified according to kind.
1986	Semi-conductor devices, coconut oil, electronic microcircuits, copper metal	Mineral fuels, lubricants & related materials, materials & accessories for the manufacture of electrical equipment, machinery other than electric, electrical machinery, apparatus & appliances.
1988	Semi-conductor devices, coconut oil, electronic microcircuits, copper metal	Mineral fuels, lubricants & related materials, machinery other than electric, base metals, electrical machinery, apparatus & appliances.
1990	Semi-conductor devices, consigned children's & infants' wear, coconut oil	Mineral fuels, lubricants & related materials, machinery other than electric, materials & accessories for the manufacture of electrical equipment, base metals.

Source: DER-International, Central Bank of the Philippines.

The bulk of long-term financing in manufacturing by commercial banks remained to be in the food, beverage, and tobacco group, which comprised about 53 per cent of total long-term financing for 1980-1990 (Table 10.14). The share to total manufacturing financing of this group, however, had been declining from 72 per cent in 1982 to 41 per cent in 1990. The rest of the group had relatively smaller average shares to total funding, led by fabricated metals (7.9 per cent), textile and chemical groups (6.7 per cent each), paper group (6.4 per cent), other manufacturing products (5.9 per cent), and basic metals (5.8 per cent). The other groups had shares of 5 per cent and below. As of end-1990, the group which received major financing shares were the following: food, beverage, and tobacco (41 per cent); basic metals (13 per cent); chemicals, petroleum, coal, and rubber (12 per cent); other manufacturing products (10 per cent); and textile, wearing apparels, and leather (9 per cent). These major groups include the following items: crude coconut oil, distilling/rectifying liquors, malt liquors, knitting mills, ready-made clothes, rattan furnitures, basic industrial chemicals, paper and paper products, cement, and basic industrial metals. It may be noted that most of these items were also major manufacturing exports of the country during the period.

1.1.5 Equity Investments of Commercial Banks in Non-Allied Undertakings

Aside from loans, commercial banks also provide funding to the agricultural and manufacturing sectors in the form of equity investments. But this privilege is limited only to commercial banks with expanded banking functions or unibanks. Based on available data for 1982-89, unibanks invested an average of P116.6 million and P167.2 million in equities in the agricultural and manufacturing sectors, respectively (Table 10.15). These amounts comprised 23.3 per cent and 33.4 per cent of the total equity investments in non-allied undertakings of unibanks during the period. They were, however, only about 1 per cent of the total resources of unibanks at that time. This minimal investment in this kind of undertaking was attributed largely to the perception of commercial banks that equity investments carried higher risks but lower returns on investment compared to investments in loans and securities.[2]

---

2 Cintura, Putong, and Silvosa, "What Keeps Unibanks from Investing in Non-Allied Undertakings?", *CB Review*, November 1990, pp. 18-23.

Table 10.14

LONG-TERM FINANCING IN MANUFACTURING OF COMMERCIAL BANKS, BY PRODUCT, 1980-1990 1/

(Per Cent Distribution)

Product	1980	1981 a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
Food, beverage and tobacco	55.4	65.3	71.7	43.9	46.1	56.8	63.6	42.3	54.3	42.1	41.1	53.0
Textile, wearing apparels & leather	10.6	4.8	6.0	10.7	10.3	6.2	6.5	4.8	3.3	1.9	8.7	6.7
Wood and wood products (including furniture)	2.8	5.9	4.1	1.2	1.1	2.8	0.8	1.2	0.9	1.0	3.9	2.3
Paper and paper products (including printing)	11.0	3.3	3.5	4.7	4.5	7.7	6.9	9.1	8.7	7.4	4.1	6.4
Chemicals, petroleum, coal & rubber	7.0	5.8	5.4	6.4	5.1	6.8	5.6	7.8	4.1	8.1	11.6	6.7
Non-metallic minerals	2.2	5.0	3.0	13.9	13.4	4.3	1.9	0.1	5.5	3.1	5.9	5.3
Basic metals	-	-	0.7	2.1	2.0	3.1	1.8	1.7	17.6	21.7	13.1	5.8
Fabricated metals	10.3	8.6	5.2	12.5	12.3	9.8	12.4	10.7	2.6	0.4	2.0	.9
Other manufacturing products	0.7	1.3	0.4	4.6	5.2	2.5	0.5	22.3	3.0	14.3	9.6	5.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

1 As of 1990, commercial banks supplied around 79 percent of aggregate long-term financing for the manufacturing sector.

\- Less than 0.1 percent.

a/ Based on 1st quarter 1982 data.

b/ Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

1.1.6 Development Bank of the Philippines

The profile of long-term bank lending to the manufacturing and agricultural sectors would not be completed if the possible contributions of the DBP were not cited. Of the three major government banks Philippine National Bank (PNB), Land Bank of the Philippines (LBP), and DBP, only DBP was not included in this paper due to incomplete and incomparable data (PNB and LBP were included in the commercial bank group). Based on its 1990 financial statements, DBP could be considered as a major contributor to long-term financing. Out of its P10.5 billion in outstanding loans and advances, P7.7 billion or about 73 per cent were chanelled to agricultural (P1.3 billion) and industrial (P6.4 billion) sectors. Assuming that its long-term loans were 10 per cent (average ratio for commercial banks, Table 10.6) of its total loans, and 50 per cent of its industrial loans were granted to manufacturing projects, its long-term exposures to the agricultural and manufacturing sectors would amount to about P130 million and P320 million, respectively, during the year or about 13 per cent and 29 per cent of the total outstanding loan in the agricultural and manufacturing sectors of commercial banks, savings banks, and specialized government banks. This could be a conservative estimate, given the fact that DBP is the major wholesale bank in the country and therefore, its loans would relatively have longer maturities compared to other commercial and specialized government banks. In addition, during the same period, DBP had an outstanding gross equity investments of P298.8 million, mostly placed in private corporations (59 per cent) and private development banks (31 per cent). The basic thrust of DBP in the future is to lend to export and other basic support sectors of industry. It also aims to influence substantially the interest rate structure for long-term funds in the country.[3]

1.1.7 Other Institutions Providing Long-Term Financing to the Agricultural and Manufacturing Sectors

Rural banks also provide long-term financing mostly to the agricultural sectors and countryside borrowers. In 1980-90, rural banks granted a total of P16.9 billion in medium- and long-term loans to the agricultural sectors or about 27.6 per cent of their total loans granted during the period (Table 10.16). No data for the manufacturing sector was available but as an indicative figure, total long-term grants for the industrial sector amounted to only P2.1 billion or about 3.5 per cent of total loan grants for the period. In terms of growth rate, however, industrial loans by rural banks registered a higher average of 15.3 per cent compared to 3.6 per cent in the agricultural sector, indicating that rural banks had also started to give greater attention to the agricultural sector.

Another group of banks that provided significant long-term financing to the agricultural and manufacturing sectors were the private development banks (PDBs). Although about half of their loanable funds during the period under review went to financing, insurance and other

---

3 1990 *Annual Report*, Development Bank of the Philippines.

Table 10.15

GROSS EQUITY INVESTMENTS OF UNIBANKS IN NON-ALLIED UNDERTAKINGS, 1982-1989 */

(By Investment Areas; In Million Pesos)

	1982		1983		1984		1985		1986		1987		1988		1989		Average	
No. of investing unibanks	4		7		7		7		9		8		8		9		7	
No. of enterprises invested in	9		31		34		34		38		29		33		28		30	
Investment areas																		
Agriculture	0.9	(0.4)	79.2	(13.4)	126.8	(19.9)	129.5	(19.5)	83.6	(15.8)	56.3	(21.1)	238.0	(45.4)	218.4	(39.1)	99.6	(24.1)
Manufacturing	0.0	0.0	211.0	(35.8)	205.3	(32.2)	230.3	(34.7)	120.0	(22.7)	131.3	(49.3)	209.0	(39.8)	230.8	(41.4)	140.4	(34.0)
Public utilities:																		
Communications	45.3	19.5)	45.5	(7.7)	39.2	(6.2)	39.2	(5.9)	46.6	(8.8)	25.0	(9.4)	54.1	(10.3)	29.5	(5.3)	32.1	(7.8)
Others	31.4	(13.5)	32.2	(5.5)	32.2	(5.1)	32.2	(4.8)	31.3	(5.9)	29.4	(11.0)	1.6	(0.3)	1.5	(0.3)	18.2	(4.4)
Mining and quarrying	0.0	0.0	63.4	(10.7)	74.1	(11.6)	74.1	(11.2)	74.1	(14.0)	4.3	(1.6)	7.0	(1.3)	4.2	(0.8)	31.3	(7.6)
Tourism	1.5	(0.6)	1.5	(0.3)	1.5	(0.2)	1.5	(0.2)	1.5	(0.3)	1.5	(0.6)	1.5	(0.3)	0.0	0.0	1.0	(0.2)
Others	152.7	(65.9)	157.2(	26.6)	157.6	(24.8)	157.6	(23.7)	172.0	(32.5)	18.6	(7.0)	13.5	(2.6)	73.6	(13.2)	90.0	(21.8)
T o t a l	231.8	(100.0)	590.0	(100.0)	636.7	(100.0)	664.4	(100.0)	529.1	(100.0)	266.4	(100.0)	524.7	(100.0)	558.0	(100.0)	412.6	(100.0)

Note: Figures in parentheses are shares to total investments for each year.

*/ Unibanks are commercial banks with expanded commercial banking functions, including investment banking.

Source: DER-Domestic and SES Department IV, Central Bank of the Philippines.

business services, they also granted significant amounts to the manufacturing sector (13.2 per cent) and the agricultural sector (14.0 per cent) (Table 10.16a). PDBs had also started to shift their lending direction to the manufacturing sector as indicated by the average growth rate in the sector of 40.6 per cent compared to 29.7 per cent in the agricultural sector.

Non-bank financial institutions also extend financing to agriculture and industry, but only at minimum amounts, the bulk of their funds being primarily channelled to consumption and real estate loans (Table 10.17). Available data, however, do not include possible substantial exposures from investment houses and financing companies (such as the Private Development Corporation of the Philippines and the Bancom Development Corporation) and several venture capital corporations also operating in the country.

1.2 Sources of Long-Term Financing

To promote the country's agricultural and development programs, the PNB, the DBP, and the LBP were specifically authorized by their respective charters to grant long-term loans. However, due to the growing financial needs of the economy, other financial institutions were also allowed to grant long-term credits. Savings banks were authorized to extend long-term credits for livestock breeding and other productive enterprises, as well as for the acquisition of equipment, machineries and other fixed assets. Rural banks were allowed to grant long-term loans for the purchase of farmlands and for the improvement of agricultural, commercial, industrial and residential real estate. The Private Development Bank Act provided that 75 per cent of the loanable funds of private development banks shall be invested in medium- and long-term loans for economic development purposes. Savings and loan associations were also authorized to grant long-term loans to finance agricultural projects.

Institutional credit for long-term financing were obtained from both foreign and domestic sources, but the bulk came from domestic sources such as deposits, capital and domestic borrowings. For commercial banks, domestic sources came mostly from deposits. Of the total external assistance, a large portion was provided by multilateral sources such as the International Bank for Reconstruction and Development (IBRD) and the Asian Development Bank (ADB).

Table 10.16

LOANS GRANTED BY RURAL BANKS, BY PURPOSE, 1980-1990

(In Thousand Pesos)

Purpose	1980		1981		1982		1983		1984		1985		1986		1987		1988		1989		1990		Total	
1. Agricultural																								
a. Crops (short-term)	1985.9	(52.6)	2110.0	(48.1)	2326.0	(44.7)	2538.0	(44.4)	1866.3	(42.1)	1656.1	(42.6)	1786.9	(40.0)	2132.3	(37.7)	2437.8	(37.4)	2797.6	(35.1)	3131.6	(33.5)	24768.5	(40.4)
b. Non-crops & other agricultural loans (medium & long-term)	1271.4	(33.7)	1619.9	(36.9)	1980.7	(38.1)	2072.3	(36.2)	1495.5	(33.8)	1122.8	(28.9)	1161.2	(26.0)	1324.2	(23.4)	1417.0	(21.7)	1605.1	(20.1)	1861.5	(19.9)	16931.6	(27.6)
Sub-total	3257.3	(86.3)	3729.9	(85.0)	4306.7	(82.8)	4610.3	(80.6)	3361.8	(75.9)	2778.9	(71.4)	2948.1	(66.0)	3456.5	(61.2)	3854.8	(59.2)	4402.7	(55.2)	4993.1	(53.4)	41700.1	(68.0)
2. Industrial 1/	105.5	(2.8)	116.2	(2.6)	156.0	(3.0)	154.1	(2.7)	139.8	(3.2)	124.9	(3.2)	143.8	(3.2)	204.8	(3.6)	249.1	(3.8)	349.4	(4.4)	386.7	(4.1)	2130.3	(3.5)
3. Commercial	330.6	(8.8)	397.3	(9.1)	545.5	(10.5)	666.9	(11.7)	604.1	(13.6)	566.7	(14.6)	785.7	(17.6)	1099.9	(19.5)	1279.8	(19.6)	1760..8	(22.1)	2039.2	(21.8)	10076.5	(16.4)
4. Others	82.0	(2.2)	145.5	(3.3)	196.1	(3.8)	289.9	(5.1)	323.2	(7.3)	420.7	(10.8)	589.2	(13.2)	888.9	(15.7)	1132.4	(17.4)	1463.2	(18.3)	1930.3	(20.6)	7461.4	(12.2)
5. Total	3775.4	(100.0)	4388.9	(100.0)	5204.3	(100.0)	5721.2	(100.0)	4428.9	(100.0)	3891.2	(100.0)	4466.8	(100.0)	5650.1	(100.0)	6516.1	(100.0)	7676.1	(100.0)	9349.3	(100.0)	61368.3	(100.0)
Selected Growth Rates																							Average	
Agricultural Non-crops (1.b)			27.4		22.3		4.6		-27.8		-24.9		3.4		14.0		7.0		13.3		16.0		5.5	
Industrial (2)			10.1		34.3		-1.2		-9.3		-10.7		15.1		42.4		21.6		40.3		10.7		15.3	
Total (5)			16.2		18.6		9.9		-22.6		-12.1		14.8		26.5		15.3		22.4		17.2		10.6	

Note: Figures in parentheses are per cent shares to total; figures may not add to totals due to rounding.

1/ Maturity breakdown not available.

Source: Central Bank of the Philippines, *Annual Report of the Rural Banking System of the Philippines,* various years.

Table 10.16a

LOANS GRANTED BY PRIVATE DEVELOPMENT BANKS, BY INDUSTRY 1980-1990

(In Million Pesos)

Industry	1980		1981		1982		1983		1984		1985		1986		1987		1988		1989		1990		Total	
Agricultural fishery, and forestry	185.4	(27.7)	280.0	(24.9)	408.2	(19.8)	348.6	(9.0)	330.9	(15.3)	352.3	(12.0)	858.2	(13.8)	1013.5	(13.5)	1190.3	(14.7)	1482.0	(14.5)	1337.5	(12.2)	7786.9	(14.0)
Mining and quarrying	5.0	(0.7)	1.3	(0.1)	7.7	(0.4)	4.1	(0.1)	16.2	(0.7)	34.4	(1.2)	5.6	(0.1)	13.6	(0.2)	4.9	(0.1)	28.1	(0.3)	28.2	(0.3)	149.1	(0.3)
Manufacturing	195.2	(29.2)	237.7	(21.1)	484.3	(23.5)	415.0	(10.7)	193.3	(8.9)	572.4	(19.6)	522.8	(8.4)	742.0	(9.9)	931.2	(11.5)	1103.5	(10.8)	1934.9	(17.7)	7332.3	(13.2)
Electricity, gas, and water	-	-	0.1	(0.0)	17.2	(0.8)	32.5	(0.8)	28.6	(1.3)	5.7	(0.2)	2.9	(0.0)	2.2	(0.0)	6.8	(0.1)	3.0	(0.0)	29.1	(0.3)	128.1	(0.2)
Construction	9.5	(1.4)	21.6	(1.9)	44.2	(2.1)	50.5	(1.3)	43.2	(2.0)	32.2	(1.1)	19.6	(0.3)	52.5	(0.7)	70.1	(0.9)	168.4	(1.7)	151.0	(1.4)	662.8	(1.2)
Wholesale and retail trade	25.6	(3.8)	67.8	(6.0)	48.9	(2.4)	65.0	(1.7)	83.6	(3.9)	44.6	(1.5)	89.4	(1.4)	53.9	(0.7)	81.5	(1.0)	154.0	(1.5)	186.8	(1.7)	901.1	(1.6)
Transportation, storage, and communication	16.7	(2.5)	21.2	(1.9)	56.6	(2.7)	89.3	(2.3)	58.5	(2.7)	146.2	(5.0)	56.8	(0.9)	33.4	(0.4)	36.6	(0.5)	57.7	(0.6)	104.8	(1.0)	677.8	(1.2)
Financial, insurance, and business services	146.9	(22.0)	270.5	(24.1)	603.0	(29.3)	2131.1	(55.0)	1015.1	(46.9)	968.0	(33.1)	2588.5	(41.7)	4600.5	(61.3)	4537.2	(56.1)	4971.7	(48.8)	5847.5	(53.5)	27680.0	(49.7)
Real estate	62.7	(9.4)	186.6	(16.6)	341.6	(16.6)	667.3	(17.2)	349.5	(16.2)	226.0	(7.7)	184.3	(3.0)	222.9	(3.0)	417.2	(5.2)	653.1	(6.4)	727.3	(6.7)	4038.5	(7.2)
Commercial, social, and personal services	21.4	(3.2)	37.4	(3.3)	47.3	(2.3)	70.9	(1.8)	45.1	(2.1)	544.9	(18.6)	1884.5	(30.3)	768.3	(10.2)	804.7	(10.0)	1564.5	(15.4)	587.0	(5.4)	6376.0	(11.4)
Total	668.4	(100.0)	1124.2	(100.0)	2059.0	(100.0)	3874.3	(100.0)	2164.0	(100.0)	2926.7	(100.0)	6212.6	(100.0)	7502.8	(100.0)	8080.5	(100.0)	10186.0	(100.0)	10934.1	(100.0)	55732.6	(100.0)

Note: Figures in parentheses are per cent shares to total; figures may not add to totals due to rounding.

Source: Central Bank of the Philippines, *Annual Report (Volume II)*, various years.

Table 10.17

LOANS OUTSTANDING OF SELECTED NON-BANK FINANCIAL INSTITUTIONS 1/, BY PURPOSE, 1980-1990

(In Million Pesos)

Purpose	1980		1981		1982		1983		1984		1985		1986		1987		1988		1989		1990		Total	
Private Non-Banks																								
Agricultural	0.6	(0.2)	0.8	(0.2)	1.4	(0.3)	3.0	(0.6)	3.6	(0.6)	1.8	(0.5)	0.6	(0.1)	- 2.4	(0.2)	3.3	(0.1)	4.0	(0.1)	4.5	(0.1)	2.4	(0.2)
Industrial	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.6	(0.0)	-	-	37.8	(1.0)	3.5	(0.3)
Commercial	3.4	(1.2)	5.5	(1.5)	10.0	(2.1)	6.9	(1.4)	8.5	(1.4)	10.0	(2.7)	33.6	(3.7)	42.5	(2.7)	23.0	(1.0)	79.3	(2.2)	89.2	(2.3)	28.4	(2.1)
Real Estate	56.3	(20.2)	77.5	(21.4)	93.8	(19.7)	111.6	(22.0)	130.2	(21.4)	74.0	(19.7)	111.5	(12.1)	101.0	(6.5)	21.9	(1.0)	280.4	(7.8)	286.8	(7.3)	122.3	(9.1)
Consumption	218.8	(78.4)	277.6	(76.8)	372.0	(78.0)	386.5	(76.1)	465.1	(76.6)	195.5	(52.1)	660.9	(72.0)	1127.5	(72.2)	1560.1	(69.7)	2843.5	(79.4)	3232.9	(82.5)	1030.9	(76.5)
Others	-	-	-	-	-	-	-	-	-	-	94.2	(25.1)	111.5	(12.1)	287.6	(18.4)	628.9	(28.1)	373.0	(10.4)	269.7	(6.9)	160.4	(11.9)
TOTAL	279.1	(100 0)	361.4	(100.0)	477.2	(100.0)	508.0	(100.0)	607.4	(100.0)	375.5	(100.0)	918.1	(100.0)	1561.0	(100.0)	2237.8	(100.0)	3580.2	(100.0)	3920.9	(100.0)	1347.9	(100.0)
Government Non-Banks																								
Real Estate	4312.0	(43.2)	4603.8	(35.9)	4326.4	(30.4)	4845.3	(28.4)	5248.5	(25.4)	5753.8	(21.6)	6048.0	(20.9)	4653.7	(31.6)	5436.9	(28.3)	5434.5	(21.0)	5422.3	(18.0)	5098.7	(25.5)
Consumption	2132.3	(21.3)	2636.8	(20.6)	3026.8	(21.3)	3268.2	(19.1)	3960.5	(19.2)	4485.5	(16.9)	5198.6	(18.0)	6440.4	(43.7)	9304.2	(48.3)	12118.7	(46.9)	15657.9	(52.1)	6202.7	(31.0)
Others	3545.9	(35.5)	5580.0	(43.5)	6861.8	(48.3)	8967.3	(52.5)	11433.0	(55.4)	16377.4	(61.5)	17673.0	(61.1)	3647.5	(24.7)	4503.0	(23.4)	8304.5	(32.1)	8989.6	(29.9)	8716.6	(43.5)
TOTAL	9990.2	(100.0)	12820.6	(100.0)	14215.0	(100.0)	17080.8	(100.0)	20642.0	(100.0)	26616.7	(100.0)	28919.6	(100.0)	14741.6	(100.0)	19244.1	(100.0)	25857.7	(100.0)	30069.8	(100.0)	20018.0	(100.0)

Note: Figures in parentheses are per cent shares to total.

1/ Consisting of private non-banks (non-stock SLAs & mutual benefits & loan associations) and government non-banks (Government Service Insurance System & Social Security System).

Source: Central Bank of the Philippines, *Annual Report (Volume II)*, various years.

Based on available data, commercial banks provided the bulk of long-term financing in agriculture (58.7 per cent) and manufacturing (78.8 per cent) as of end-1990 (Table 10.18). Specialized government banks provided 39.6 per cent of long-term financing in agriculture, but only 1.4 per cent of long-term financing in manufacturing. Savings banks, on the other hand, supplied 19.8 per cent of long-term funds in manufacturing while providing only 1.7 per cent in agriculture.

In terms of sectoral shares in aggregate long-term financing by each institution for the period 1980-1990, commercial banks allocated about 4 to 20 per cent of their total agricultural financing to long-term grants, while providing a larger portion of about 11 to 30 per cent of their total manufacturing funds to long-term loans (Table 10.18a). The same trend was evident for savings banks during the same period, but only on a lower scale, thus: in agriculture, 1 to 7 per cent; in manufacturing, 2 to 16 per cent (Table 10.18c). On the other hand, specialized government banks channelled more of their funds to agriculture (32 to 79 per cent) than to manufacturing (1 to 9 per cent) (Table 10.18b).

Table 10.18

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS BY INSTITUTION
(As of End-1990)

(In Million Pesos)

Institution	Agricultural Sector			Manufacturing Sector			All Sectors	
	Amount		Percent of total	Amount		Percent of total	Amount	Percent of total
Commercial Banks	572	(9.1)	58.7	869	(13.8)	78.8	6,287	59.8
Specialized Government Banks	386	(79.3)	39.6	15	(3.0)	1.4	487	4.6
Savings Banks	17	(0.4)	1.7	219	(5.9)	19.9	3,737	35.6
Total	975	(9.3)	100.0	1,103	(10.5)	100.0	10,511	100.0

Note: Figures in parentheses represent the sectoral share in aggregate long-term financing by each institution.

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.18a

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS OF COMMERCIAL BANKS
1980-1990

(In Million Pesos)

Year	Agricultural Sector		Manufacturing Sector		All Sectors	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
1980	383.11	4.02	2,735.53	28.67	9,541.34	100.00
1981 a/	591.42	6.40	2,249.43	24.35	9,238.74	100.00
1982	1,516.75	11.97	3,748.43	29.57	12,675.45	100.00
1983 b/	1,187.48	19.73	1,560.33	25.92	6,020.04	100.00
1984	572.85	8.23	1,616.76	23.22	6,962.37	100.00
1985	1,025.60	18.67	1,629.41	29.65	5,494.72	100.00
1986	420.18	5.75	2,205.08	30.17	7,309.20	100.00
1987	285.47	5.50	1,496.20	28.80	5,194.28	100.00
1988	741.96	7.80	1,506.16	15.84	9,510.39	100.00
1989	1,218.89	12.63	1,046.61	10.84	9,652.50	100.00
1990	572.23	9.10	869.47	13.83	6,287.25	100.00

a/ Based on 1st quarter 1982 data.
b/ Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.18b

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS OF SPECIALIZED GOVERNMENT BANKS, 1980-1990

(In Million Pesos)

Year	Agricultural Sector		Manufacturing Sector		All Sectors	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
1980	608.86	41.84	13.73	0.94	1455.19	100.00
1981	592.08	31.65	15.77	0.84	1870.97	100.00
1982	420.48	44.69	29.80	3.17	940.84	100.00
1983	407.22	31.96	22.24	1.75	1274.27	100.00
1984	385.50	39.17	28.95	2.94	984.04	100.00
1985	388.59	46.28	22.70	2.70	839.60	100.00
1986	358.01	43.64	75.04	9.15	820.45	100.00
1987	297.62	39.46	33.52	4.44	754.15	100.00
1988	267.08	36.85	37.40	5.16	724.81	100.00
1989	243.68	41.97	24.79	4.27	580.65	100.00
1990	386.05	79.29	14.83	3.04	486.90	100.00

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.18c

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS OF SAVINGS BANKS
1980-1990

(In Million Pesos)

Year	Agricultural Sector		Manufacturing Sector		All Sectors	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
1980	80.53	5.74	46.32	3.30	1,401.77	100.00
1981	61.02	4.57	37.06	2.77	1,336.61	100.00
1982	41.51	3.26	27.79	2.19	1,271.44	100.00
1983	64.94	4.58	37.36	2.64	1,417.41	100.00
1984	54.64	3.64	98.69	6.57	1,502.19	100.00
1985	26.27	3.49	117.47	15.62	751.96	100.00
1986	55.18	4.77	111.69	9.66	1,156.10	100.00
1987	49.61	5.87	63.64	7.53	845.03	100.00
1988	29.33	3.00	126.41	12.92	978.51	100.00
1989	104.30	6.72	179.54	11.56	1,552.53	100.00
1990	16.97	0.45	218.72	5.85	3,736.89	100.00

Source: DER-Domestic, Central Bank of the Philippines.

Over the years, the sources of funds of the Philippine banking system had further shifted from borrowings (28 to 10.3 per cent) to deposits (from 46.2 per cent to 60.6 per cent) (Table 10.19). Capital, surplus and other sources of funds generally maintained their respective shares during the period.

The bulk of commercial bank funds came from deposits (47 to 65 per cent) and borrowings (10 to 29 per cent) (Table 10.20). The same were true with savings banks and specialized government banks, except that the latter had a smaller amount of deposits (Tables 10.21 and 10.22).

There were in addition informal or non-institutional sources of credit available for the agricultural and manufacturing sectors such as those coming from landlords, merchants, relatives and unlicensed money lenders. Based on various surveys, the dependence on informal sources of credits was as high as 90 per cent in 1954-61, decreasing to 35 per

Table 10.19

SOURCES OF FUNDS OF THE PHILIPPINE BANKING SYSTEM, 1980-1990

(In Million Pesos)

Year	Deposits	Borrowings	Capital Stock	Others	Total
1980	89,498.2	54,199.0	13,189.9	36,712.1	193,599.2
	(46.2)	(28.0)	(6.8)	(19.0)	(100.0)
1981	99,594.2	71,096.0	15,471.7	42,418.1	228,580.0
	(43.6)	(31.1)	(6.8)	(18.6)	(100.0)
1982	119,364.5	88,825.8	18,308.0	49,558.3	276,056.6
	(43.2)	(32.2)	(6.6)	(18.0)	(100.0)
1983	142,181.7	100,088.4	20,642.4	68,030.9	330,943.4
	(43.0)	(30.2)	(6.2)	(20.6)	(100.0)
1984	153,472.4	129,732.7	21,915.6	91,318.4	396,439.1
	(38.7)	(32.7)	(5.5)	(23.0)	(100.0)
1985	164,255.7	124,705.6	36,925.5	61,882.3	387,769.1
	(42.4)	(32.2)	(9.5)	(16.0)	(100.0)
1986	166,275.0	41,551.0	38,818.0	42,813.0	289,457.0
	(57.4)	(14.4)	(13.4)	(14.8)	(100.0)
1987	177,981.0	30,407.0	20,092.0	72,144.0	300,624.0
	(59.2)	(10.1)	(6.7)	(24.0)	(100.0)
1988	226,598.0	32,826.0	22,735.0	78,218.0	360,377.0
	(62.9)	(9.1)	(6.3)	(21.7)	(100.0)
1989	289,847.0	46,201.0	25,914.0	103,502.0	465,464.0
	(62.3)	(9.9)	(5.6)	(22.2)	(100.0)
1990	359,017.0	61,137.0	30,343.0	141,526.0	592,023.0
	(60.6)	(10.3)	(5.1)	(23.9)	(100.0)

Note: Figures in parentheses represent percent of total.

Source: Central Bank of the Philippines, *Fact Book: Philippine Financial System,* various years.

Table 10.20

SOURCES OF FUNDS OF THE COMMERCIAL BANKING SYSTEM, 1980-1990

(In Million Pesos)

Year	Deposits	Borrowings	Capital Stock	Others	Total
1980	72,913.1	35,178.9	7,058.6	29,277.4	144,428.0
	(50.5)	(24.4)	(4.9)	(20.3)	(100.0)
1981	80,026.2	47,427.4	8,675.3	32,892.3	169,021.2
	(47.3)	(28.1)	(5.1)	(19.5)	(100.0)
1982	97,688.7	59,023.6	10,410.5	37,397.2	204,520.0
	(47.8)	(28.9)	(5.1)	(18.3)	(100.0)
1983	120,511.0	64,386.0	12,247.0	51,189.0	248,333.0
	(48.5)	(25.9)	(4.9)	(20.6)	(100.0)
1984	138,216.0	74,774.0	13,234.0	65,651.0	291,875.0
	(47.4)	(25.6)	(4.5)	(22.5)	(100.0)
1985	144,053.0	65,937.0	14,856.0	54,472.0	279,318.0
	(51.6)	(23.6)	(5.3)	(19.5)	(100.0)
1986	141,158.0	33,772.0	12,726.0	49,399.0	237,055.0
	(59.5)	(14.2)	(5.4)	(20.8)	(100.0)
1987	153,336.0	23,911.0	12,809.0	57,180.0	247,236.0
	(62.0)	(9.7)	(5.2)	(23.1)	(100.0)
1988	195,898.0	27,038.0	15,472.0	61,210.0	299,618.0
	(65.4)	(9.0)	(5.2)	(20.4)	(100.0)
1989	253,368.0	39,982.0	18,015.0	83,001.0	394,366.0
	(64.2)	(10.1)	(4.6)	(21.0)	(100.0)
1990	312,979.0	51,675.0	21,754.0	114,732.0	501,140.0
	(62.5)	(10.3)	(4.3)	(22.9)	(100.0)

Note: Figures in parentheses represent percent of total.

Source: Central Bank of the Philippines, *Fact Book: Philippine Financial System,* various years.

Table 10.21

SOURCES OF FUNDS OF THE SAVINGS BANKING SYSTEM, 1980-1990

(In Million Pesos)

Year	Deposits	Borrowings	Capital Stock	Others	Total
1980	6,115.6	93.3	517.1	626.6	7,352.6
	(83.2)	(1.3)	(7.0)	(8.5)	(100.0)
1981	4,553.0	1,467.8	444.9	440.6	6,906.3
	(65.9)	(21.3)	(6.4)	(6.4)	(100.0)
1982	5,089.1	87.1	333.5	360.4	5,870.1
	(86.7)	(1.5)	(5.7)	(6.1)	(100.0)
1983	5,952.7	330.8	431.6	676.1	7,391.2
	(80.5)	(4.5)	(5.8)	(9.1)	(100.0)
1984	3,032.4	3,554.4	453.4	566.6	7,606.8
	(39.9)	(46.7)	(6.0)	(7.4)	(100.0)
1985	5,625.5	337.6	340.5	493.0	6,796.6
	(82.8)	(5.0)	(5.0)	(7.3)	(100.0)
1986	6,961.0	171.0	429.0	536.0	8,097.0
	(86.0)	(2.1)	(5.3)	(6.6)	(100.0)
1987	9,198.0	83.0	506.0	781.0	10,568.0
	(87.0)	(0.8)	(4.8)	(7.4)	(100.0)
1988	2,408.0	405.0	475.0	737.0	4,025.0
	(59.8)	(10.1)	(11.8)	(18.3)	(100.0)
1989	2,966.0	395.0	463.0	433.0	4,257.0
	(69.7)	(9.3)	(10.9)	(10.2)	(100.0)
1990	3,027.0	260.0	514.0	592.0	4,393.0
	(68.9)	(5.9)	(11.7)	(13.5)	(100.0)

Note: Figures in parentheses represent percent of total.

Source: Central Bank of the Philippines, *Fact Book: Philippine Financial System,* various years.

Table 10.22

SOURCES OF FUNDS OF SPECIALIZED GOVERNMENT BANKS, 1980-1990

(In Million Pesos)

Year	Deposits	Borrowings	Capital Stock	Others	Total
1980	6,899.8	15,539.9	4,562.7	6,097.5	33,099.9
	(20.8)	(46.9)	(13.8)	(18.4)	(100.0)
1981	10,292.8	18,027.0	5,062.9	8,105.4	41,488.1
	(24.8)	(43.5)	(12.2)	(19.5)	(100.0)
1982	9,808.2	24,750.2	5,929.6	10,517.0	51,005.0
	(19.2)	(48.5)	(11.6)	(20.6)	(100.0)
1983	7,368.4	29,483.5	6,002.4	14,330.9	57,185.2
	(12.9)	(51.6)	(10.5)	(25.1)	(100.0)
1984	5,446.0	45,777.0	6,260.0	23,340.0	80,823.0
	(6.7)	(56.6)	(7.7)	(28.9)	(100.0)
1985	6,901.0	53,395.0	19,653.0	4,942.0	84,891.0
	(8.1)	(62.9)	(23.2)	(5.8)	(100.0)
1986	8,577.0	2,866.0	23,557.0	(9,248.0)	25,752.0
	(33.3)	(11.1)	(91.5)	(-35.9)	(100.0)
1987	5,307.0	2,202.0	4,583.0	12,098.0	24,190.0
	(21.9)	(9.1)	(18.9)	(50.0)	(100.0)
1988	6,847.0	1,224.0	4,350.0	12,768.0	25,189.0
	(27.2)	(4.9)	(17.3)	(50.7)	(100.0)
1989	6,182.0	1,213.0	4,350.0	14,989.0	26,734.0
	(23.1)	(4.5)	(16.3)	(56.1)	(100.0)
1990	12,189.0	3,817.0	4,350.0	19,774.0	40,130.0
	(30.4)	(9.5)	(10.8)	(49.3)	(100.0)

Note: Figures in parentheses represent percent of total.

Source: Central Bank of the Philippines, *Fact Book: Philippine Financial System*, various years.

cent in 1975-76, and averaging from 10 to 50 per cent in the mid-80s. In the agricultural sector, about two-thirds of all Filipino farmers borrowed from informal lenders during the 1980s.

Compared to banks, informal lenders were more accessible to borrowers, giving loans at the farmer's house and collecting repayments at the farm gate. They also required less paperwork and collateral. However, they compensated these greater accessibility by charging higher nominal rates of interest, and lending at mostly short-term maturities.

1.3 Lending Policies and Procedures

During the period 1950-1980, lending policies and procedures by financial institutions were highly regulated, particularly in terms of interest rates and amounts. Starting in the early 1980s up to the present, when the financial system had been susbstantially deregulated, lending policies had become more liberalized. However, general prudential requirements remain, such as single borrowers' limit and collateral requirements, as well as the usual quotas for priority sectors.

The following section is a typical profile of regulations on long-term financing. They were based mainly on past experiences of banks participating in the CB-IBRD Special Financing Programs which have provided substantial long-term financing to agriculture and industry.

1.3.1 Qualified Borrowers

All corporations, entities and individuals engaged in agriculture as well as in the manufacture of agricultural machineries and equipment. Farms cultivated should not be more than 50 hectares while capital should not exceed P500,000.00

1.3.2 Purpose of Loan

All activities which are viable and where the potential for increased production is clearly established. Specific projects qualified include purchase of farm land for agricultural production, improvement of agricultural real estate, acquisition of agricultural or industrial machinery as well as farm mechanization, light transportation, cottage and agro-business.

1.3.3 Amount of Loan

This depends upon the cost of the project, actual needs of borrower and collateral offered; however, it should not exceed 70 per cent of appraised value of property offered as security.

1.3.4 Loan Maturities

Shall not exceed the economic life of the project to be financed.

1.3.5 Collateral

Loans may be secured by a first mortgage on titled or untitled immovable property and/or chattel mortgage on movable property, production stock, government bonds and securities.

1.3.6 Interest

The government set maximum and minimum guiding interest rates during the early 1960s and 1970s. At present, interest rates are being reviewed quarterly on a fixed or floating rate at the option of the borrowers and the banks.

1.3.7 Lending Procedures

Application procedures are prescribed by the Central Bank including the investigation and verification as well as the appraisal of the creditworthiness of the borrowers. Central Bank loan teams also evaluate and approve loan applications and supervise project implementation.

In general, most banks are conservative with regard to providing long-term loans to borrowers because of the high risk involved in carrying this type of loan. This perception among banks has not been changed by the existence of some guarantee schemes made available to banks by the government, mainly because they apply mostly to short-term credits.

II. The Role of the Central Bank of the Philippines (CBP) in Long-Term Financing for Manufacturing and Agricultural Sectors

Since lending is the essence of banking, the formulation and implementation of sound lending policies are among the most important responsibilities of banks. The CBP, being the supervisory body of the banking system, assumes an active role in the formulation of lending policies of banking institutions by issuing rules and regulations within which banks will have to operate, including rules on long-term lending. These rules and regulations range from setting interest rate limits and loan values to allocating credit flows to priority sectors of the economy. As of end-1990, there were over 7,000 banking offices under CBP supervision and regulation (Table 10.23).

Table 10.23

SUPERVISION OF FINANCIAL INSTITUTIONS
(As of End-1990)

Institution	No.	Supervised and Examined by
Commercial banks	1,863	Supervision & Examination Sector, Central Bank of the Philippines
Specialized government banks	76	Supervision & Examination Sector, Central Bank of the Philippines
Thrift banks	653	Supervision & Examination Sector, Central Bank of the Philippines
Rural banks	1,045	Supervision & Examination Sector, Central Bank of the Philippines
Non-bank financial institutions	3,845	Supervision & Examination Sector, Central Bank of the Philippines

Source: Central Bank of the Philippines, *Fact Book: Philippine Financial System* (1990).

The CBP is also authorized to engage in lending to banks, non-bank financial institutions and, in special cases, to key public and private corporations. Section 86 of the Philippine Central Bank Act outlines CBP's overall credit policy, which is "to regulate the volume, cost availability and character of bank credit and to provide the banking system with liquid funds in times of need". During inflationary times, the CBP "shall refrain from extending credits to banks" except in special cases justified by circumstances. Conversely, in deflationary periods, the CBP "shall make full use of the credit operations" authorized under the charter.

Over the years, the bulk of the CBP's lending operations have been short-term in nature. Moreover, starting in the late 1980s, it has gradually phased-out most of its direct lending operations, particularly those arising out of the special funds being administered by it, to concentrate more on its main function of maintaining stability in the monetary system.

2.1 Financing Facilities of the Central Bank of the Philippines

There are three major types of credit operations that the CBP is authorized to engage in under its charter: normal, special, and emergency credit operations. The first and the last essentially involve short-term facilities in the form of rediscounting loans and emergency and provisional advances to banks and other key public financial institutions. In 1990, the main recipients of CB rediscount funds were the commercial banks and rural banks (Table 10.24). Most of the CB loan grants were channelled to exports (Table 10.25). It is through the second type that the CBP engages in some form of long-term financing. Special credit operations include loans and advances to banks and non-bank financial intermediaries engaged in long-term lending, as well as advances for purposes of bank mergers and consolidations or the rehabilitation of industries. Under this special financing facility, the CBP also administers special funds co-financed with various private and public international financial institutions. These special funds include the Agricultural Loan Fund (ALF), the Industrial Guarantee Loan Fund (IGLF), and similar funds intended for a specific purpose or sector of the economy. The ALF and the IGLF, however, have been the major source of long-term credit granted by the CBP over the years. Under these special funds, the agricultural and manufacturing sectors have been given priority and preferential interest rates and payment schemes. For the period 1985-89, the CBP had administered the granting of ALF loans totalling P4.1 billion, most of which went into projects in agro-processing facilities (32 per cent), seasonal crops (23.6 per cent), and livelihood and poultry (21.5 per cent) (Table 10.26). On the other hand, IGLF loans administered by the CBP amounted to P5.2 billion for the period 1980-1989, 98 per cent of which were used to fund manufacturing projects such as food, garments, and metal production (Table 10.27). Because of the shorter life of their projects, more ALF loans had short-term maturities (52 per cent) than IGLF loans (2.3 per cent) (Table 10.28). IGLF loans, on the other hand, financed more projects in the nature of fixed assets (34.1 per cent) than ALF loans (20.3 per cent) (Table 10.29).

Moreover, the CBP, through the Department of Loans and Credit (DLC), normally and regularly undertakes credit operations with banking institutions in the Philippines in the form of rediscounts, loans or advances against bills, acceptances, promissory notes and other credit instruments at prescribed maturity periods under existing rediscounting

Table 10.24

OUTSTANDING LOAN BALANCES OF INSTITUTIONAL BORROWERS WITH THE CENTRAL BANK

(As of end-1990)

Banks	Amount (Mil. Pesos)	Percent to Total (%)
Commercial banks	6,046	35.1
Rural banks	2,316	13.5
Thrift banks	280	1.6
Land Bank of the Philippines (LBP)	366	2.1
Non-banks (NBQBs)	343	2.0
CB Regional Offices (CBROs)	545	3.2
Total	9,896	57.5
National/Local Governments	4,558	26.5
Philippine Deposit Insurance Corporation (PDIC)	2,750	16.0
Total	7,308	42.5
Grand Total	17,204	100.0

Source: Department of Loans and Credit, Central Bank of the Philippines.

Table 10.25

LOANS GRANTED BY THE CENTRAL BANK OF THE PHILIPPINES TO COMMERCIAL BANKS, CLASSIFIED BY PURPOSE, 1990

(In Million Pesos)

Purpose	Agricultural	Non Agricultural	Total
Traditional Exports	2,793.1	935.7	3,728.8
Non-traditional Exports	3,581.7	12,919.0	16,500.7
Total	6,374.8	13,854.7	20,229.5
Quedans	750.0	0.0	750.0
Equity Investments	0.0	118.5	118.5
Grand Total	7,124.8	13,973.2	21,098.0

Source: Department of Loans and Credit, Central Bank of the Philippines.

Table 10.26

AGRICULTURAL LOAN FUND (ALF) LOANS GRANTED, BY PROJECTS, 1985-1989

(In Million Pesos)

Project	1985		1986		1987		1988		1989		Total	
Fisheries	69.9	(18.7)	19.0	(5.4)	62.1	(16.6)	182.3	(22.8)	289.2	(12.9)	622.5	(15.0)
Livestock and Poultry	0.4	(0.1)	45.4	(12.8)	78.9	(21.0)	220.6	(27.6)	547.0	(24.4)	892.3	(21.5)
Plantation Crops	144.7	(38.6)	12.8	(3.6)	4.4	(1.2)	63.9	(8.0)	101.2	(4.5)	327.0	(7.9)
Agro-Processing Facilities	52.2	(13.9)	30.5	(8.6)	40.6	(10.8)	129.2	(16.2)	1073.7	(47.9)	1326.2	(32.0)
Seasonal Crops	107.5	(28.7)	245.8	(69.5)	189.1	(50.4)	202.0	(25.3)	231.3	(10.3)	975.7	(23.5)
Farm Mechanization	-		-		-		-		0.3	(0.0)	0.3	(0.0)
TOTAL	374.7	(100.0)	353.5	(100.0)	375.1	(100.0)	798.0	(100.0)	2242.7	(100.0)	4144.0	(100.0)

Notes: Figures in parentheses are percent shares to total.
ALF started only in 1985. In 1990, ALF administration was transferred to the Land Bank of the Philippines.

Source: Department of Loans and Credit, Central Bank of the Philippines.

regulations. Special and emergency credits may likewise be extended by the Central Bank to banking institutions upon prior approval by the Monetary Board.

For normal credit operations, the Central Bank through the DLC may rediscount or grant short-term credits in the form of: (a) commercial credits for traditional and non-traditional exports and quedan (standing crops) financing; (b) production credits for the production and processing of agricultural, animal, mineral or industrial products; (c) advances against specific collateral, including government securities and other credit instruments.

Special credit operations may also be undertaken with Monetary Board approval under special circumstances to banking institutions engaged in long-term financing; to any government financial institution in the Philippines for the purchase of shares of stocks for resale to the general public to encourage bank mergers and consolidation; and to non-bank financial intermediaries authorized to perform quasi-banking functions (NBQBs) for the twin purposes of promoting their medium- and long-term operations and maintaining their competitive positions. Emergency credit operations may, with the consent of the Monetary Board, be undertaken by the Central Bank in periods of emergency or

Table 10.27

INDUSTRIAL GUARANTEE LOAN FUND (IGLF) LOANS GRANTED, BY INDUSTRY, 1980-1989
(In Million Pesos)

Purpose	1980		1981		1982		1983		1984		1985		1986		1987		1988		1989 a/		Total	
Manufacturing																						
Food and food products	25.8	(17.5)	32.7	(14.0)	29.0	(15.4)	19.2	(9.1)	140.2	(28.9)	224.7	(36.5)	59.9	(26.8)	56.2	(17.4)	216.9	(14.2)	135.1	(10.9)	939.7	(18.1)
Beverages	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	0.8	(0.1)	5.5	(0.4)	6.3	(0.1)
Tobacco	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Textiles	4.5	(3.1)	0.5	(0.2)	4.6	(2.4)	12.3	(5.8)	22.1	(4.6)	20.6	(3.3)	12.8	(5.7)	25.0	(7.7)	90.9	(5.9)	81.0	(6.5)	274.3	(5.3)
Footwear/Apparel/ Garments	13.5	(9.2)	28.8	(12.3)	16.4	(8.7)	28.3	(13.4)	43.3	(8.9)	48.8	(7.9)	34.4	(15.4)	56.8	(17.6)	270.7	(17.7)	272.7	(22.0)	813.7	(15.7)
Wood & wood products	5.2	(3.5)	5.2	(2.2)	26.4	(14.0)	7.7	(3.6)	38.1	(7.9)	36.0	(5.8)	4.3	(1.9)	12.7	(3.9)	118.5	(7.8)	33.8	(2.7)	287.9	(5.5)
Furniture & fixtures	7.2	(4.9)	8.6	(3.7)	9.1	(4.8)	14.5	(6.9)	15.6	(3.2)	34.5	(5.6)	14.1	(6.3)	13.3	(4.1)	69.7	(4.6)	39.1	(3.2)	225.7	(4.3)
Paper & paper products	4.0	(2.7)	8.2	(3.5)	5.8	(3.1)	15.4	(7.3)	21.5	(4.4)	15.2	(2.5)	4.4	(2.0)	17.5	(5.4)	95.0	(6.2)	38.1	(3.1)	225.1	(4.3)
Printing/Publishing/ Allied industries	5.9	(4.0)	15.2	(6.5)	11.9	(6.3)	9.1	(4.3)	6.0	(1.2)	18.3	(3.0)	7.5	(3.3)	28.2	(8.7)	23.8	(1.6)	58.2	(4.7)	184.1	(3.5)
Leather & leather products	1.5	(1.0)	0.8	(0.3)	2.0	(1.1)	2.6	(1.2)	6.7	(1.4)	5.0	(0.8)	0.3	(0.1)	-	-	29.8	(1.9)	61.1	(4.9)	109.8	(2.1)
Rubber & rubber products	1.0	(0.7)	3.7	(1.6)	6.5	(3.5)	9.4	(4.4)	13.6	(2.8)	9.4	(1.5)	2.4	(1.1)	10.6	(3.3)	72.9	(4.8)	16.0	(1.3)	145.5	(2.8)
Chemical & chemical products	7.2	(4.9)	17.8	(7.6)	7.0	(3.7)	7.4	(3.5)	29.6	(6.1)	21.7	(3.5)	11.9	(5.3)	8.0	(2.5)	138.2	(9.0)	133.1	(10.7)	381.9	(7.3)
Non-metallic mineral products	4.3	(2.9)	6.4	(2.7)	4.4	(2.3)	15.8	(7.5)	20.4	(4.2)	18.6	(3.0)	8.2	(3.7)	5.5	(1.7)	44.6	(2.9)	53.3	(4.3)	181.5	(3.5)
Basic metals	-	-	7.7	(3.3)	12.8	(6.8)	-	-	4.5	(0.9)	11.7	(1.9)	-	-	-	-	45.7	(3.0)	11.1	(0.9)	93.5	(1.8)
Metal products	26.0	(17.7)	30.7	(13.1)	8.8	(4.7)	22.1	(10.4)	48.8	(10.1)	51.7	(8.4)	25.8	(11.5)	45.9	(14.2)	143.4	(9.4)	164.3	(13.3)	567.5	(10.9)
Electrical machineries/ appliances	6.5	(4.4)	5.5	(2.3)	7.8	(4.1)	6.4	(3.0)	8.7	(1.8)	12.2	(2.0)	6.4	(2.9)	1.5	(0.5)	27.9	(1.8)	22.6	(1.8)	105.5	(2.0)
Non-electrical machineries appliances	3.5	(2.4)	1.6	(0.7)	6.4	(3.4)	6.1	(2.9)	1.0	(0.2)	6.1	(1.0)	1.8	(0.8)	6.0	(1.9)	13.0	(0.9)	6.4	(0.5)	51.9	(1.0)
Transport equipment	4.0	(2.7)	5.2	(2.2)	6.8	(3.6)	2.7	(1.3)	8.7	(1.8)	5.8	(0.9)	-	-	-	-	36.3	(2.4)	28.0	(2.3)	97.5	(1.9)
Miscellaneous manufactures	19.1	(13.0)	52.6	(22.4)	21.9	(11.6)	24.4	(11.5)	41.2	(8.5)	69.8	(11.3)	27.6	(12.3)	27.6	(8.6)	58.7	(3.8)	58.8	(4.7)	401.7	(7.7)
Sub-total	139.2	(94.6)	231.2	(98.6)	187.6	(99.6)	203.4	(96.1)	470.0	(97.0)	610.1	(99.1)	221.8	(99.1)	314.8	(97.6)	1496.8	(97.9)	1218.2	(98.3)	5093.1	(98.0)
Construction	2.5	(1.7)	-	-	-	-	3.2	(1.5)	-	-	1.2	(0.2)	-	-	-	-	-	-	-	-	6.9	(0.1)
Tourism	2.6	(1.8)	1.6	(0.7)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4.2	(0.1)
Other services	2.9	(2.0)	1.6	(0.7)	0.8	(0.4)	5.0	(2.4)	14.7	(3.0)	4.6	(0.7)	2.1	(0.9)	7.9	(2.4)	31.7	(2.1)	21.5	(1.7)	92.8	(1.8)
Total	147.2	(100.0)	234.4	(100.0)	188.4	(100.0)	211.6	(100.0)	484.7	(100.0)	615.9	(100.0)	223.9	(100.0)	322.7	(100.0)	1528.5	(100.0)	1239.7	(100.0)	5197.0	(100.0)

Note: Figures in parentheses represent per cent to total.

a/ After 1989, administration of the IGLF was transferred to the Development Bank of the Philippines.

Source: Department of Loans and Credit, Central Bank of the Philippines.

Table 10.28

AGRICULTURAL LOAN FUND (ALF) AND INDUSTRIAL GUARANTEE LOAN FUND (IGLF) LOANS GRANTED, BY MATURITY, 1980-1989
(In Million Pesos)

Purpose	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Total
ALF :											
Short-Term	-	-	-	-	-	371.0 (99.0)	291.6 (82.5)	132.8 (35.4)	510.7 (64.0)	847.7 (37.8)	2153.8 (52.0)
Medium- & Long-Term	-	-	-	-	-	3.7 (1.0)	61.9 (17.5)	242.3 (64.6)	287.3 (36.0)	1395.0 (62.2)	1990.2 (48.0)
Total	-	-	-	-	-	374.7 (100.0)	353.5 (100.0)	375.1 (100.0)	798.0 (100.0)	2242.7 (100.0)	4144.0 (100.0)
IGLF :											
Short-Term	-	-	-	-	-	-	-	12.0 (3.7)	61.4 (4.0)	47.2 (3.8)	120.6 (2.3)
Medium- & Long-Term	147.2 (100.0)	234.4 (100.0)	188.4 (100.0)	211.6 (100.0)	484.7 (100.0)	615.9 (100.0)	223.9 (100.0)	310.7 (96.3)	1467.1 (96.0)	1192.5 (96.2)	5076.4 (97.7)
Medium- & Long-Term	147.2 (100.0)	234.4 (100.0)	188.4 (100.0)	211.6 (100.0)	484.7 (100.0)	615.9 (100.0)	223.9 (100.0)	322.7 (100.0)	1528.5 (100.0)	1239.7 (100.0)	5197.0 (100.0)

Note: Figures in parentheses are per cent shares to total.
ALF started only in 1985. Starting 1990, ALF administration was transferred to the Land Bank of the Philippines, while IGLF administration was transferred to the Development Bank of the Philippines.

Source: Department of Loans and Credit, Central Bank of the Philippines.

Table 10.29

AGRICULTURAL LOAN FUND (ALF) AND INDUSTRIAL GUARANTEE LOAN FUND (IGLF) LOANS GRANTED, BY PURPOSE, 1980-1989

(In Million Pesos)

Purpose	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	Total
ALF :											
Fixed assets	-	-	-	-	-	-	4.6 (1.3)	(52.4 (14.0)	176.8 (22.2)	608.1 (27.1)	841.8 (20.3)
Fixed assets & working capital	-	-	-	-	-	-	99.0 (28.0)	56.6 (15.1)	38.9 (4.9)	175.6 (7.8)	370.1 (8.9)
Working capital	-	-	-	-	-	0.8 (0.2)	70.3 (19.9)	164.0 (43.7)	267.1 (33.5)	1156.5 (51.6)	1658.7 (40.0)
Production credit	-	-	-	-	-	373.9 (99.8)	179.7 (50.8)	102.1 (27.2)	315.2 (39.5)	302.5 (13.5)	1273.4 (30.7)
Total	-	-	-	-	-	374.7 (100.0)	353.5 (100.0)	375.1 (100.0)	798.0 (100.0)	2242.7 (100.0)	4144.0 (100.0)
IGLF :											
Fixed assets	123.5 (83.9)	205.6 (87.7)	166.4 (88.3)	157.7 (74.5)	84.3 (17.4)	110.1 (17.9)	46.1 (20.6)	120.9 (37.5)	411.3 (26.9)	347.4 (28.0)	1773.3 (34.1)
Working capital	23.7 (16.1)	28.8 (12.3)	22.0 (11.7)	53.9 (25.5)	400.4 (82.6)	505.8 (82.1)	177.8 (79.4)	201.8 (62.5)	1117.2 (73.1)	892.3 (72.0)	3423.7 (65.9)
Total	147.2 (100.0)	234.4 (100.0)	188.4 (100.0)	211.6 (100.0)	484.7 (100.0)	615.9 (100.0)	223.9 (100.0)	322.7 (100.0)	1528.5 (100.0)	1239.7 (100.0)	5197.0 (100.0)

Note: Figures in parentheses are per cent shares to total.
ALF started only in 1985. Starting 1990, ALF administration was transferred to the Land Bank of the Philippines, while IGLF administration was transferred to the Development Bank of the Philippines.

Source: Department of Loans and Credit, Central Bank of the Philippines.

of imminent financial panic which directly threaten monetary and banking institutions secured by assets acceptable to the Monetary Board. Emergency credit operations may also be undertaken, even during normal periods, to assist a bank in a precarious condition or under serious financial pressures brought about by unforseen events, or events, which though forseeable, could not be prevented by the bank concerned, provided among others that the bank is not insolvent and has clearly realizable assets to secure the advances.

The Central Bank may undertake credit operations with the Government or with any of its political subdivisions through direct provisional advances to finance expenditures authorized in the annual appropriation of the borrowing entity; provided that said advances must be repaid before the end of the first quarter following the end of the fiscal year of the Government or political subdivision and shall not, in their aggregate, exceed 20 per cent of the average annual income of the borrower for the last three preceding fiscal years.

The DLC's activities as the domestic lending arm of the CB are as follows:

1. Examines all applications for loans, advances and rediscounts and determines the eligibiliPPty and acceptability of collateral documents in accordance with existing banking statutes and implementing credit policies of the Monetary Board;

2. Conducts credit examination/investigation of the institutional borrowers of the Central Bank, particularly banks and NBQBs;

3. Prepares reports to the Governor and/or Monetary Board regarding its lending activities and submits data necessary for the determination of interest and rediscount rates, the composition of the Central Bank portfolio and other pertinent data;

4. Submits policy recommendations relating to rediscounting and implementing guidelines, rules and regulations pertaining to the rediscounting process;

5. Records and accounts for all financial transactions;

6. Collects/services loan accounts;

7. Controls and accounts for collateral documents securing credit availments;

8. Compiles and undertakes analysis of accumulated statistical data for use in reports and technical studies;

9. Coordinates with departments concerned in the implementation of policies adopted by the Monetary Board;

10. Submits comments and observations on proposed legislations and other proposals pertaining to or referred to the DLC; and

11. Provides data and other information to other departments or offices monitoring various credit operations of the Central Bank.

In addition, the DLC monitors the administration by the LBP and the DBP of the ALF and the APEX programs, respectively, including the collection from the LBP and the DBP of loan amortizations at maturity as well as the repayment of maturing loan obligations to foreign creditors. The DLC has also been designated as trustee of the Educational Loan Guarantee Fund of the Department of Education, Culture and Sports (see attached organizational chart of the DLC).

2.2 Regulations

As the supervisory body of the banking system, the CBP issues rules and regulations within which banks are to operate, including rules on long-term lending. In addition, certain categories of banks are authorized under the General Banking Act or by their respective charters (in the case of government banks) to engage in long-term financing, subject to limitations contained in the aforementioned act/ charters.

The CBP issues regulations in the following areas for long-term lending: single-borrower's loan limit; maximum maturity periods; loan purpose; acceptable collaterals and their respective loan values; repayment guidelines; collection and past due loan requirements; renewal/ extension guidelines; credit accommodations to directors, officers and stockholders of banks.

In addition, other monetary and fiscal regulations affect long-term lending. These include: (a) credit quotas that require banks to lend certain amounts to identified priority sectors and geographical areas; (b) taxes on gross receipts and on interest on deposits; (c) historically high reserve requirements; and (d) special financing programs. All these either limit the amount of loanable funds by banks or distort the pricing of such loans, resulting in inefficiencies in the flow of credit.

2.3 Supervision Problems

The CBP oversees the long-term lending operations of financial institutions under its supervision both directly and indirectly. Indirect supervision of bank lending activities are made through the various general limitations and requirements embodied in the rules and regulations it issues such as those enumerated in the preceding section. Direct supervision of bank lending activities is conducted through periodic examinations of individual banks.

In the case of agricultural loans under special financing programs, it is the Agricultural Credit Supervisor (ACS) who, together with the bank examiner, establishes direct contact with the bank management as well as the borrower to evaluate the status of various financing projects. There are two general categories by which the ACS oversees the agricultural projects of banks, operationalized by categorizing each loan as either supervised or non-supervised. Supervised loans are differentiated from non-supervised loans by the additional farm plan and budget requirement. This requirement ensures that the ACS will coordinate with the borrower from the initial preparation of the plan to its final execution and completion.

In general, the rules are adequate to facilitate sound lending practices. However, it is the manner of enforcing these rules that needs to be improved. Under pending bills in Congress, amendments in the CBP charter have been proposed to give CBP personnel more legal powers and protection in the supervision of banks, particularly problem banks.

2.4 Implications for the Central Bank of the Philippines

The main dilemma of the CBP is whether or not to continue its substantial participation in the financing of developmental projects, including long-term loans, or to gradually phase out this function and concentrate on its monetary stabilization function. Some sectors believe that the subsidized credits being granted by the CBP under its rediscounting facility and administered special financing programs distort the flow of credit to its most optimal use. On the other hand, some sectors argue that the CBP could more efficiently handle these financing facilities than if such are transferred to government banks, as in the case of the Industrial Guarantee Loan Fund (IGLF) and other export financing schemes. Moreover, the rediscounting facility is one of the CBP's monetary instruments in managing monetary aggregates.

Lately, however, this dilemma appears to have been resolved. Administration of the IGLF and the ALF had been transferred to the DBP and the LBP, respectively. Pending bills in Congress, which aim to establish a more independent and financially stronger CBP, contain provisions that prohibit CBP from exercising development financing functions, except in cases where it will merely serve as a conduit for funds coming from international financial institutions. One of the main thrusts of the bill is to eliminate CBP's substantial losses from operations, one of the sources of which is the CBP's lower-than-market interest income from its subsidized rediscounting and special financing facilities.

III. Issues and Suggestions in Long-Term Financing for Manufacturing and Agricultural Sectors

3.1 Factors Limiting Access to Institutional Credit and Repayment Problems

Starting in the 1980s, the Philippine financial system has gradually shifted away from its supply-led financing strategy characterized by repressed and fragmented interest rate structures and targetted lending programs. At present, interest rates on loans and deposits have been substantially market-determined while special lending programs have been generally rationalized and reduced in number. Out of the several remaining special programs by the government and the private sector, however, only a limited number provide long-term financing to the manufacturing and agricultural sectors (Table 10.30). Other current reforms supporting financial liberalization include: liberalization of the foreign exchange market and transactions, more open bank branching policies; more areas for equity investments in non-allied undertakings; rehabilitation of failed banks and proposals for entry of foreign banks. All these reforms facilitate more competition and efficiency and additional sources of financing within the financial system.

While these reforms have generally contributed to greater access to institutional credit, some regulations and policies have remained that still limit the flow of credit, including long-term credit, to end-users. These include the quotas on credit (Agri-Agra Law, 25 per cent of loanable funds to agriculture, 5 to 10 per cent to small- and medium-size enterprises, lending to areas where banks source their deposits), gross receipt tax on bank income, historically high reserve requirements, special lending programs. These regulations tend to either restrict the amount of credit available or influence their flow to less productive/viable projects by distorting their prices.

Another source of the lack of funding for long-term projects is the structure of banks' main source of funding, i.e., deposits. Demand, saving, and time deposits are short-term in nature so that banks tend to replicate this maturity structure in their loan portfolios. Unless, therefore, long-term sources of borrowings by banks are found, their long-term loan grants will remain minimal.

On the matter of repayments, there are no significant cases of loan defaults and delinquency in long-term loans granted by banks because of the strict collateral requirement they impose on the borrowers. In some isolated cases, collateral deficiencies may arise from some self-dealing activities of bank management.

3.2 Future Needs of Long-Term Financing for Manufacturing and Agricultural Sectors

Due to limited data, the econometric model designed for this section yielded unreliable results. In its place, growth scenarios based on actual past trends were formulated to arrive at possible future growth directions of the sectors for the next five years (1991-95). The growth scenarios were at best indicative since they were based solely on past growth rates, and other specific influencing elements such as interest rates, demand for credit, and level of savings were not factored in.

Table 10.30

LENDING AND GUARANTEE PROGRAMS PROVIDING LONG–TERM FINANCING TO THE MANUFACTURING AND AGRICULTURAL SECTORS

(As of 1992)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
1. Farmer's Cooperative Fixed Asset Acquisition Program	For acquiring and managing agricultural machineries and equipment related to production operations	Duly registered cooperatives whose majority members are small farmers and fisherfolks	80% LBP loan 15% DA equity 5% cooperative equity	Aligned with LBP lending policies	10	DA, LBP
2. Asian Development Bank-Third Development Bank of the Phil. Project (ADB III DBP Project)	For new production facilities or modernization, expansion and upgrading of existing ones	Lead borrowers (PFIs): Commercial banks, thrift banks, leasing & financing companies, investment houses Sub-borrowers: Private sector SMIs, private firms	Sub-loan or lease investment 90% (max.) - DBP 10% (min.) - PFIs Machinery/equipment (3-12 yrs./3 grace) Working capital (3-7 yrs./3 grace) Lease financing (3-12 years incl. of grace) FIRR and EIRR of at least 15% Long-term debt to equity ratio not exceeding 2:1	DBP to PFIs: Market-based, fixed or variable at PFIs' option PFIs to sub-borrowers: Market-based, fixed or variable at sub-borrowers' option	NA	DBP, PFIs

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
3. Industrial guarantee and loan Fund (IGLF)	Facility from the USAID, WB, & ADB for onlending to eligible CSMIs engaged inthe manufacture of processing on a commercial scale and in the delivery of services supportive of manufacturing activities through accredited financial institutions	PFIs and CSMIs with assets of less than P20 million before financing	Technical, economic financial feasibility Sub-loans: Accredition scheme (up to P20 million) Sponsorship scheme (up to P 150 thousand) Repayment terms: at least se mestrally Fixed assets - 12 years (3 years grace) Permanent working capital–7 years (2 years grace) Subject to post–audit by DBP	DBPs to PFIs: Set by Review Committee on se mestral basis using market source rate available at variable or fixed term interest rate. Fixed rate is adjusted every 5 yrs. whereas variable rate is reviewed every 6 months. PFIs to sub-borrowers: Market lending rate at PFIs option	NA	DBP, PFIs
4. Overseas Economic Cooperation Fund–Asean Japan Development Fund Loan (OECF-AJDF)	Credit facility from OECF-AJDF available to PFIs for onlending to investment enterprise (IEs) financing long-term requirements (i.e., land improvements, plant construction/expansion acquisition of machinery, equipment and initial working capital)	Lead borrowers: Commercial and thrift banks Sub-borrowers: IEs with total assets of less thann p200 million before financing and with loan requirements of less than P100 million	80% DBP/OECF-AJDF equity; 20% sub-borrowers' equity Minimum Loanable fund-P50 thousand Maximum loanable fund-P100 million Post-audit by DBP or OECF-AJDF Repayment period: 3 to 15 years, with 5 yeaars grace	DBP to PFIs: Market source rate (variable or fixed) at PFIs option PFIs to sub-borrowers: Market lending rate at PFIs option (with maximum spread of 5%)	NA	DBP, PFIs

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
5. Fisheries Guarantee Fund (FGF)	Designed to increase productivity of the agriculture sector in 6 identified regions and to provide alternative livelihood to fish-farmers in 12 identified bays	Individual, partnerships, corporations, associations, and cooperatives	Fixed asset loan: maximum of 10 years, inclusive of 2 years grace Borrowers' equity: not less than 20% Loan sizes: individual–P150 thousand to P2 million group–P3 million to P10 million	Set by lending PFI	NA	GFSME
6. Guarantee Opportunities for Light Industries (GOLD) Program	For acquisition of fixed assets, building improvement/expansion or construction of plant facilities; permanent working capital	Individuals or enterprises engaged in small- or medium-scale projects	Loan sizes: Small-scale-P50 thousand to P4 million Medium-scale–P50 thousand to P8 million Maturity: maximum of 10 years, inclusive of 1 year grace period Guarantee fee: 2% of guarantee portion of outstanding loan	Set by lending PFI	NA	GFSME

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
7. GFSME–Regular Guarantee Facility (RGF)	Main guarantee program of the GFSME created to stimulate lending to small– and medium–scale enterprises (SMIs) involved in agriculture and agro-forestry for domestic or export markets. Provides 85% of outstanding loan guarantee coverage and 100% maximum guarantee on portion of loan not covered by real estate collateral.	Individuals or enterprises	Loan sizes: Small–scale–not more than P5 million Medium–scale–P5 million to P20 million IRR of at least 20% Maturity: 10 years, inclusive of 2 years grace period Borrowers' equity: not less than 20%	Fixed of floating at option of GFSME or originating PFIs	P300 millin seed fund	GFSME, PFIs
8. Cattle Financing for Cooperatives (CFC)	Program for small farmers cooperatives duly registered with the CDA	Small farmers cooperatives with actual/related experience in cattle raising	Maturity: 5-7 years, inclusive of grace Loanable amount depends on project needs (no ceiling)	12	NA Source: ARF	LBP, CDA
9. Countryside Loan Fund (CLF)	Once implemented, this program will replace the ALF program	Eligible PFIs Sub-borrowers: 1. Single proprietorship/Filipino 2. Partnership/Filipino 3. Corporation – at least 70% Filipino–owned	Loan size: P100 thousand to PFIs' single borrowers' limit Financing package: LBP – 75% Borrower – 25% Maturity: 15 years, inclusive of grace	Based on WAIR plus premium of 1 to 2 %	$150 million – WB	LBP, WB

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
10. Lending Program to Farmers' Cooperatives: Livelihood Opportunities (Rotary Village Corp.)	Partnership between LBP and RCP; taps LBPs' willingness to provide livelihood financing & tha Rotarians' initiative to organize & guide farmers & fishermen into becoming bankable entities	Cooperatives registered with CDA; farmer groups registered with SEC or Bureau of Rural Works-DOLE; land reform farmer beneficiaries; other small farmers	Repayment term: 3 to 10 yeears Production & fixed assets loans only	12 - 16	Sources: ARF & LBP Corporate Funds	LBP, Rotary Club of the Phil., NAFC, Philam Foundation
11. General Facility Program for Medium and Large Industries	Covers needs of medium and large exporters, either for guarantee support on term loans, project finance or on bonding requirements for overseas contracts and/or foreign-funded domestic projects	Export producers/traders	Phil guarantee to guarantee 70% of proposed credit facility and establish the single borrower's limit at an amount not to exceed its total subscribed capital; Filing fee and guarantee fee	NA	NA	Philguarantee
12. PHINMA Venture Capital Corporation (PHINMA-VCC)	Financial assistance in the form of equity investments instead of traditional credit to the following industries: cement, paper, packaging, construction, trading, growth industries, food processing, exports, aquaculture, & agriculture	Small/medium-scale entrepreneurs with existing financial investments in enterprises of outstanding growth potential	Maximum project size: P5 million Equity limit: 35% to 50%	NA	NA	PVCC
13. SSS Kabalikat sa Pagpapaunlad ng Industriya (KASAPI II)	Created by SSS as abusiness rehabilitation program for small & medium scale industries affected/damaged by Mt. Pinatubo's eruption	SM is directly affected or bonafide victims of Mt. Pinatubo's eruption & with assets of not more than P30 million before financing; debt to equity ratio of not more than 75:25; also PFIs and individual borrowers	Maximum term: 7 years Loan sizes: For PFIs-up to its net-worth level For IBs-P1-P10 million	For PFIs - 12 with spread of not more than 4 For IBs - 16	P500 million Source: KASAPI II II Fund	SSS, PFIs

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
14. SSS Small and Medium Industries Loan Program (SMILP)	For SMIs specifically engaged in agribusiness, manufacturing, utilities, transportation and communications, commercial production of basis consumer items & export related business	Individuals, partnerships & corporations with assets and equity of at least P2 million & P200,000, respectively	Repayment term: maximum of 10 years, including 2 years grace Size per project: P20 million	For PFIs - 13 with spread of not more than 4%	P750 million	SSS, LBP, PNB, DBP
15. Agro-Industrial Technology Transfer Program (AITTP)	Funded by the Japan OECF to facilitate transfer of technology for production & processing in the countryside, develop domestic & export markets & generate livelihood opportunities. Three lending windows are available: (1) Anchor Project Financing; (2) Small Farmers Lending (3) Pioneer Technology Commercialization	Windows 1 & 3 Corporaations Window 2: Individuals, corporations or registered farmers cooperatives/associations	Project ceilings: Window 1 - P40 million Windows @ & 3 - P10 million (after financing)	13	NA	TLRC-AITTD
16. Technology Utilization Financing Program (TUFP)	Provides funding & management services for pilot-tested, new or improved appropriate & marketable technology ready for commercial production; Aims to help technology developers bring to market the benefits of their inventions	R & D institutions; individuals; Filipino or majority-owned by Filipinos	Loan size ceiling: P2.5 million 100% collateral coverage Repayment term: based on project cash flow	15	NA	TLRC
17. Small Business Loan Portfolio Guarantee Program (LPG)	AUSAID credit guarantee facility designed to encourage banks & other financial institutions to increase the amount of credit extended to qualified small business enterprises. Covers up to 50% of accredited banks' lending to target beneficiaries	Selected private banks & financial institutions engaged in small-scale enterprise lending	Loan size ceiling: $150,000 Guarantee coverage: 3-9 years	Front-end fee of 0.5% of amount of facility Utilization fee- 1 1/2% of average outstanding loan	$15 million	USAID, accredited PFIs

Table 10.30 (Cont'd)

Name	Description	Eligible Borrowers	Terms/Requirements	Interest Rate (Percent)	Funds Available (Mil. P)	Participating/ Implementing Financial Institution/ Government Agency
18. Small Enterprises Credit (SEC) Project	Funded by the USAID to help the country's private development banks increase their loan portfolios to SMEs	SMEs engaged in any off-farm or non-production activities located outside the National Capital Region	Loan size ceilings: Small business-P2.5 million Medium-sized business-P5 million Lending PDB determines collateral requirement	Based on prevailing market rate or the moving weighted average of the last two available quarters of 360-day times deposits, subject to quarterly review	$12 million	USAID; accredited PDBs

Legend:

ADB – Asian Development Bank
DA – Department of Agriculture
LBP – Land Bank of the Philippines
SMIs – Small and medium scale Industries
PFIs – Private financial institutions
DBP – Development Bank of the Philippines
FIRR – Financial Internal Rate of Return
EIRR – Economic Internal Rate of Return
IGLF – Industrial Guaranteeand Loan Fund
CSMI – Cottage, small & medium scale industries
WB – World Bank
OECF – Overseas Economic Cooperative Fund-Asean Japan Development Fund
IE – Investment enterprises
FGF – Fisheries Guarantee Fund
GFSME – Guarantee Fund for small & Medium Enterprises
GOLD – Guarantee Opportunities for Light Industries
RGF – Regular Guarantee Facility
IRR – Internal Rate of Return
CFC – Cattle Financing for Cooperatives
CDA – Cooperative Development Authority
ARF – Agrarian Reform Fund
SME – Small & medium scale enterprises
RVC – Rotary Village Corps
RCP – Rotary Club of the Philippines
NAFC – National Agriculture & Fishery Council
EASE – Equipment Acquisition for Small Enterprises
PHILGUARANTEE – Philippine Export & Foreign Loan Guarantee Corporation
PVCC – Phinma Venture Capital Corporation
PHINMA – Philippine Investment Management Consultants, Inc.
KASAPI – Kabalikat sa Pagpapaunlad ng Industriya
SSS – Social security System
IB – Individual borrowers
SMILP – SSS Small & Medium Industries Loan Program
AITTP – Agro-Industrial Technology Transfer Program
TUFP – Technology Utilization Financing Program
LPG – Loan Portfolio Guarantee
SEC – Small Enterprise Credit
PDBs – Private Development Banks
PDIC – Philippine Deposit Insurance Corporation

Source: Philippine Deposit Insurance Corporation (PDIC), *Financial Schemes Available to the Philippine Countryside, Third Edition, 1992.*

3.2.1 Sectoral Scenarios

Scenario A, which was based completely on the past growth rates of each sector, was basically a low-growth scenario. It was interpreted as follows: the economy would be able to achieve the same average growth rate that it experienced in the past ten years (1980-90) at half the time (1991-95). This was justified by the fact that the period 1980-90 was marred by financial and economic crises which resulted in low and even negative growth rates in some years, specifically in 1983-85. Under this scenario, long-term financing in agriculture was expected to post a positive average nominal growth rate of 7.3 per cent compared to a negative average nominal growth rate of 3.1 per cent in the manufacturing sector (Table 10.31). This meant that the manufacturing sector would be more vulnerable to the existing economic bottlenecks, such as the energy crisis, than the agriculture sector. In real terms, however, both sectors would have declines in average growth rates during the period. Under this scenario, the prevailing economic and financial problems in the last decade were seen to be essentially (partly or fully) unresolved and the economy would continue to deteriorate in the next five years.

Scenario B was regarded as the medium-growth scenario. It was based on the same actual average growth rates in 1980-90, but excluding the crisis years of 1983-85. The estimated average growth rates under this scenario was interpreted as the possible level of performance of the economy during the same period if the economic and financial crises of 1983-85 did not occur. Under this scenario, long-term financing in both the agricultural and the manufacturing sectors would be able to post positive average nominal growth rates of 12.3 and 2.5 per cent, respectively. In real terms, however, the manufacturing sector would continue to post a negative growth of 7.1 per cent while the agricultural sector would be able to realize a positive growth of 2.7 per cent. This scenario assumed a greater improvement in the economic and financial environment, but the agricultural sector was still given greater importance than the manufacturing sector. This was considered a transition period in the economy's move towards industrialization, characterized by a shift from the agricultural to the industrial sector as the major engine of economic growth.

Scenario C was considered a high-growth scenario. Based on actual growth data for 1991 and the projected growth rates for 1992-95 under

Table 10.31

INDICATIVE GROWTH RATES IN LONG-TERM FINANCING

(For the Period 1991-1995)

	Nominal Base Level 1990 (P Million)	Average Growth Rate for the 5-year Period					
		Scenario A 1/		Scenario B 2/		Scenario C 3/	
		Nominal	Real 4/	Nominal	Real 4/	Nominal	Real 4/
A. Total Long-Term Financing in:							
Agriculture	975.2	7.3	(2.3)	12.3	2.7	11.8	2.2
Manufacturing	1,103.0	(3.1)	(12.7)	2.5	(7.1)	13.6	4.0
B. Total Long-Term Financing in Agriculture By:							
Commercial banks	572.2	29.6	20.0	41.5	31.9	-	-
Savings banks	17.0	16.4	6.8	25.0	15.4	-	-
Specialized Govt. banks	386.0	(2.5)	(12.1)	(2.5)	(12.1)	-	-
B. Total Long-Term Financing in Manufacturing By:							
Commercial banks	869.5	(4.9)	(14.5)	0.8	(8.8)	-	-
Savings banks	218.7	28.7	19.1	9.9	0.3	-	-
Specialized Govt. banks	14.8	31.1	21.5	46.8	37.2	-	-

1/ Based on actual average growth rates from 1980-1990.

2/ Based on actual average growth rates from 1980-1990, except 1983-1985.

3/ Based on actual growth rates in 1991 and on the projections of the preliminary draft of the Philippine Medium-Term Development Plan (PMTDP): 1993-98 (for 1992-95). The PMTDP has no projections for long-term financing of commercial, savings, and specialized government banks. In all cases, the projected growth rate in each sector is assumed to require the same growth rate in long-term financing in said sector.

4/ Based on an average inflation rate for 1991-95 of 9.6 percent.

Sources: (Department of Economic Research, Central Bank of the Philippines; Preliminary Draft of Philippine Medium-Term Development Plan: 1993-98, NEDA..

the preliminary draft of the Philippine Medium-Term Development Plan (PMTDP) for 1993-98, the scenario estimated positive average nominal growth rates in long-term financing for the agricultural and manufacturing sectors of 11.8 per cent and 13.6 per cent, respectively. Both sectors were also expected to achieve positive real average growth rates. This time, however, the manufacturing sector was calculated to post a higher real average growth rate of 4.0 per cent compared to the 2.2 per cent estimated for the agricultural sector. This scenario indicated a take-off period for the country's industrialization as envisioned in the PMTDP.

3.2.2 Growth Scenarios by Type of Bank

Only Scenarios A and B were estimated for each type of bank (Table 10.31) since the PMTDP did not project growth rates for the banking subsectors. While commercial banks remained the major provider of long-term funds in agriculture and manufacturing (Table 10.18), past growth trends indicated that its funding for the manufacturing sector would continually decline as indicated by the negative real average growth rate of 14.5 per cent and 8.8 per cent in Scenarios A and B, respectively. This indicated that the behavior of commercial banks did not support the expected general growth trend for Scenario C, wherein the manufacturing sector was supposed to become the leading sector in the economy. This meant that if the government intended to pursue the goals envisioned in the PMTDP, specialized government banks would have to provide the momentum for growth in the manufacturing sector. This was exactly what was being observed in the growth trend among SGBs, where substantial increases in real average growth in the manufacturing sector of 21.5 per cent and 37.2 per cent, respectively, were indicated. Once the momentum was initiated and sustained and demand in the sector increased consequently, then commercial banks and even savings banks could follow the SGB example. As was observed in Table 10.33, the shift from agriculture to the manufacturing sector would not be hard to do since commercial and savings banks already supplied most of the funds loaned out to the manufacturing sector as of 1990. All these banks would have to do was to maintain the levels first (and not decrease them as indicated in Scenarios A and B), and then gradually shift more of the funds to the manufacturing sector as they were able to collect from their agricultural loans. On the other hand, the SGBs, while exhibiting positive growth rates in the manufacturing sector, had very minimal exposures in the sector as of 1990

(P14.8 million, although this could be larger if DBP exposures were included), compared to their exposures in the agricultural sector (P386.0 million) during the same period. SGBs, therefore, would have to exert extra effort in looking for additional sources of financing if they were to stimulate the growth of long-term financing in the manufacturing sector. Potential sources would include collection from their agricultural loans, mobilization of additional domestic savings, and foreign financing from official and private sources.

3.2.3 Lending Trends in Commercial Banks

Using the only available data from commercial banks as sample, the mix of products that were being financed by the banking system were analyzed as basis for determining what products would have financing potential in the next five years. In the agricultural sector, by virtue of their magnitude, agricultural crops and services would continue to dominate long-term finance with real growth rates of 28.0 per cent and 43.3 per cent, respectively, for Scenarios A and B (Table 10.31.a). By virtue of size, sugarcane and fruits would receive most of long-term funds available. Substantial growth in shares would go to livestock, poultry, coconut and agricultural services. Declines in shares were indicated for tobacco, raising of other animals and other agricultural crops, and palay. The fishery sub-sector was indicated as a rising sector with estimated real growth rates of close to 100 per cent in scenarios A and B. The main engine of growth in this sector was the operation of fish farms. The forestry sub-sector, on the other hand, was seen as a sunset sector, with estimated negative real growth rates for Scenarios A and B, mainly as a result of the continuing log ban in the country.

In the manufacturing sector, by virtue of size, the food and beverage group was found to remain as the dominant area for long-term financing. Upcoming products included basic metals, other manufacturing products, textile and wearing apparel, and chemicals and allied products. On the decline were paper and paper products, and non-metallic minerals.

3.3 Recommendations for Further Improvements

Given the prospects for long-term financing in the manufacturing and agricultural sectors in the country as discussed in the preceeding sections, some general directions for future actions may be considered.

Table 10.31a

INDICATIVE GROWTH RATES IN LONG-TERM FINANCING OF COMMERCIAL BANKS, 1991-1995

	Nominal Base Level 1990 (P Million)	Scenario A 1/		Scenario B 2/	
		Nominal	Real 3/	Nominal	Real 3/
A. Agriculture	572.2	29.6	20.0	41.5	31.9
1. Agricultural crops & Services	445.8	37.6	28.0	52.9	43.3
a. Coconut	0.1	86.3	76.7	80.9	71.3
b. Corn	0.0	1.5	(8.1)	(14.3)	(23.9)
c. Fruits & nuts	158.4	82.3	72.7	(15.5)	(25.1)
d. Palay	0.0	(1.8)	(11.4)	11.6	2.0
e. Sugarcane	240.6	13.7	4.1	57.1	47.5
f. Tobacco	0.0	(10.0)	(19.6)	(10.0)	(19.6)
g. Vegetables	0.0	10.9	1.3	6.2	(3.4)
h. Other agricultural crops, nec	0.0	(35.0)	(44.6)	(41.0)	(50.6)
i. Livestock & livestock products	8.9	13.6	4.0	9.3	(0.3)
j. Poultry & poultry products	19.0	139.6	130.0	223.7	214.1
k. Raising of other animals	10.0	(30.0)	(39.6)	(28.6)	(38.2)
l. Agricultural services	8.8	34.8	25.2	51.0	41.4
2. Fishery	126.4	109.4	99.8	156.2	146.6
a. Inland Fishing	1.0	62.6	53.0	89.4	79.8
b. Operation of fish farms	80.9	92.9	83.3	139.6	130.0
c. Ocean/coastal fishing	9.3	-	-	-	-
d. Other fishing activities	35.2	26.2	16.6	66.9	57.3
3. Forestry	0.0	(11.0)	(20.6)	5.4	(4.2)
a. Logging	0.0	(10.1)	(19.7)	6.7	(2.9)
b. Other forest activities	0.0	(20.0)	(29.6)	(20.0)	(29.6)
B. Manufacturing	869.5	(4.9)	(14.5)	0.8	(8.8)
1. Food, beverage, tobacco	357.8	(3.1)	(12.7)	(13.6)	(23.2)
2. Textile, wearing apparel and leather	75.5	15.9	6.3	31.4	21.8
3. Wood & wood products, incld. furniture	33.7	24.0	14.4	29.9	20.3
4. Paper & paper products	35.6	(5.5)	(15.1)	(12.1)	(21.7)
5. Chemicals, petroleum, coal & rubber	100.5	18.9	9.3	5.3	(4.3)
6. Non-metallic minerals	51.3	(0.6)	(10.2)	(6.9)	(16.5)
7. Basic metals	114.0	92.7	83.1	109.6	100.0
8. Fabricated metals	17.8	23.0	13.4	30.4	20.8
9. Other manufacturing products	83.3	45.4	35.8	7.6	(2.0)

1 Based on actual average growth rates from 1980-1990.
2 Based on actual average growth rates from 1980-1990, except 1983-1985.
3 Based on an average inflation rate for 1991-95 of 9.6 percent.

Source: Department of Economic Research, Central Bank of the Philippines.

On the need for matching the maturity profiles of the banks' loan portfolio with those of their borrowed funds, the following key action areas may require priority attention: tapping of potential fund sources such as insurance companies and pension funds; development of the capital market; and further mobilization of savings, particularly in the countryside. In this connection, financial reforms supporting financial liberalization such as liberalized rules on bank branching and entry of foreign banks should be continued.

Other reforms that will reduce the intermediation costs of banks such as the phase-out of the gross receipt tax on bank revenues and the reduction in reserve requirements on deposits with banks, should also be encouraged, subject to the limitations imposed by other monetary and fiscal targets of the government.

On the demand side, more entrepreneurs will have to be encouraged to put up more viable projects through such proven schemes like networking, production enhancement programs, technology transfers, and cooperative development.

In support of the above courses of action, further research on the following subjects may be conducted: impact of interest rate movements and special lending programs on long-term financing to the manufacturing and agricultural sectors; more detailed studies on the long-term exposures of DBP, private development banks, rural banks, and other non-bank financial institutions such as investment houses and financing companies; more detailed analysis of their product mix being financed; and development of appropriate models for measuring the demand for long-term credit in the manufacturing and agricultural sectors.

On the part of the CBP, efforts must be exerted to facilitate approval of pending bills in Congress that will enable the new CBP to start from a clean and more solid foundation. Once freed from its numerous development financing and other quasi-fiscal functions, the new CBP will now be able to concentrate on its primary functions of maintaining price stability and promoting a monetary and fiscal environment more conducive to a sustained and faster economic growth. In addition, the new CBP will have to further reform its supervision and regulation policies to meet the increasing need for stronger prudential regulations as a result of the ongoing liberalization of the financial system.

IV. Major Findings and Concluding Remarks

Based on available data from commercial banks, savings banks, and specialized government banks for the period 1980-1990 long-term financing for the manufacturing and agricultural sectors averaged 6.6 per cent and 11.4 per cent, respectively, of their corresponding total sectoral financing levels. While long-term financing in the agricultural sector grew at an annual average rate of 7.3 per cent, long-term financing in the manufacturing sector declined at an annual average rate of 3.1 per cent during the same period.

The combined long-term manufacturing and agricultural financing levels had steadily decreased as a proportion of the country's GDP from 1.6 per cent in 1980, to 0.2 per cent in 1990. The same trends were observed in their ratios to total exports, value-added levels, and total employment.

Commercial banks supplied the bulk of long-term funds during the period. As of end-1990, commercial banks provided 58.7 per cent of total long-term financing in agriculture and 78.8 per cent of total long-term financing in manufacturing. Specialized government banks provided 39.6 per cent of long-term financing in agriculture, but only 1.4 per cent of long-term financing in manufacturing. Savings banks, on the other hand, supplied 19.8 per cent of long-term funds in manufacturing while providing only 1.7 per cent in agriculture. Limited data indicated that rural banks and private development banks also contributed materially to long-term financing in the agriculture and manufacturing sectors.

Based solely on data from commercial banks, 67 to 98 per cent of long-term financing in agriculture were devoted to agricultural crops and services. The major products and activities funded were sugarcane, coconut, fruits and nuts, livestock and poultry, and operation of fish farms. In the manufacturing sector, commercial banks channelled about 53 per cent of their long-term funds to the food-beverage-tobacco group. Other manufacturing groups, led by fabricated metals, textile, chemicals, basic metals, paper and miscellaneous manufacturing products, had relatively smaller shares.

The main source of funds of the banks during the period had further shifted from borrowings (from 28 per cent to 10.3 per cent) to deposits (from 46.2 per cent to 60.6 per cent). The other sources of funds such as capital and surplus generally maintained their respective shares during the period.

Starting in the 1980s, the lending policies and procedures of the Philippine financial system, particularly on interest rates, had been substantially liberalized. There remained, however, certain government policies and regulations that continued to limit access to or the supply of credit, including long-term credit to the manufacturing and agricultural sectors. These policies and regulations included the Agri-Agra Law and other similar quotas on lending to certain priority sectors and geographical areas, the gross receipt tax on bank income, the historically high reserve requirements, and the special lending programs of the government. The maturity structure of the banks' borrowed fund sources (mostly short-term), also limited their long-term exposures to the agricultural and manufacturing sectors, forcing them to channel most of their loans to short-term projects.

Based on past growth trends and on the preliminary figures from the Philippine Medium-Term Development Plan for 1993-98, long-term financing in the agricultural sector was estimated to post an average real growth rate ranging from negative 2.3 per cent to positive 2.2 per cent for the period 1991-95. Long-term financing in the manufacturing sector, on the other hand, was projected to grow in real terms between negative 12.7 per cent to 4.0 per cent during the same period. The following products/activities were projected to receive most of the long-term funds available for the period: sugarcane, poultry, coconut, fruits, operation of fish farms, food manufacturing, basic metals, fabricated metals, chemicals and textile products. Most of these products were also major exports of the country.

The projected lending trends of the banks covered by the study were mixed. While commercial banks had a larger exposure to the manufacturing sector compared to the agricultural sector, the former was projected to decline in 1991-95 while the latter was estimated to accelerate during the same period. The same trend was observed for the savings banks. In the case of the specialized government banks, the opposite trend was observed. It was estimated that specialized government banks would have to continue to play a substantial role in funding long-term financing in the manufacturing sector if government was to meet its economic growth targets for 1991-95.

On the part of the Central Bank, the phase out of its development financing function to enable it to concentrate more on its main function of maintaining price stability remained to be its main policy thrust most relevant to the long-term financing issue. The approval of pending bills in Congress would allow it to be freed of its quasi-fiscal functions that required it to incur substantial losses in the past; and more effectively attend to its primary goal of maintaining a monetary and financial environment more conducive to sustain a faster economic growth. In addition, CBP will have to further improve its prudential rules and regulations to meet the changing needs of the financial system as a result of the ongoing financial liberalization in the country.

Table 10.32

LONG-TERM FINANCING IN AGRICULTURE OF COMMERCIAL BANKS BY PRODUCT, 1981-1990 1/

(Growth Rate; In Per Cent)

Product	1981a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
A. Agricultural crops & services	66.1	159.1	-26.1	-55.3	87.1	-56.7	-51.9	236.2	78.2	-61	37.6
1. Abaca	-	-	-	-	-	-	-	-	-	-	-
2. Coconut	371.8	-78.9	-60.7	-	357.4	-98.2	-	358.8	112.8	-100.0	86.3
3. Corn	-	-	-	-	114.9	-100.0	-	-	-	-	1.5
4. Fiber crops	-	-	-	-	-	-	-	-	-	-	-
5. Fruits & nuts	-	172.7	-42.3	-94.3	1067.8	-98.9	-	-82.0	-100.0	-	82.3
6. Palay	97.0	65.6	-99.1	-	-	-	-98.0	116.8	-	-100.0	-1.8
7. Sugar cane	-1.4	159.1	-97.6	-97.4	-67.9	-41.4	-	197.2	-14.8	101.0	13.7
8. Tobacco	-100.0	-	-	-	-	-	-	-	-	-	-10.0
9. Vegetables	224.8	39.9	-	63.8	1.4	-98.8	-	-22.3	-100.0	-	10.9
10. Other agricultural crops, nec	-	-70.7	-88.9	-	25.5	-41.5	-41.4	-33.2	-100.0	-	-35.0
11. Livestock & livestock products	-41.3	-	1.6	-59.8	129.7	89.6	-99.9	-	34.0	82.4	13.6
12. Poultry & poultry products	201.0	-24.9	-69.7	-100.0	-	-98.9	-15.4	82.9	-61.2	1482.2	139.6
13. Raising of other animals	-	-	-100.0	-	-	-100.0	-	-	-100.0	-	-30.0
14. Agricultural services	-	603.9	83.5	-81.8	-10.3	-46.9	-100.0	-	-100.0	-	34.8
B. Fishery	-	-67.7	-	-6.7	7.2	-92.5	1102.5	3.0	-47.0	195.4	109.4
1. Inland fishing	683.3	48.9	-	-6.0	6.5	-100.0	-	-	52.9	-59.1	62.7
2. Ocean (offshore) & coastal fishing	-	-	-	-	-	-	-	-	-	-	-
3. Operation of fish farms	140.1	40.0	-48.1	-	-	-	357.7	120.3	-69.1	387.9	92.9
4. Other fishing activities	-	251.9	-100.0	-	-	118.2	-	-53.1	-3.6	48.7	26.2
C. Forestry	-68.4	145.0	-87.1	-60.1	-	-21.1	-2.2	19.2	65.1	-100.0	-11.0
1. Logging	-59.8	145.4	-87.1	-60.1	-	-21.1	-2.2	19.2	65.1	-100.0	-10.1
2. Other forest activities	-99.5	-100.0	-	-	-	-	-	-	-	-	-20.0
Total	54.4	156.4	-21.7	-51.8	79.0	-59.0	-32.1	159.9	64.3	-53.1	29.6

1 As of end-1990, commercial banks supplied around 59 percent of the aggregate long-term financing for the agricultural sector.
– less than 0.1 percent
a Based on 1st quarter 1982 data
b Based on 1st quarter 1984 data

Source: DER-Domestic, Central Bank of the Philippines.

Table 10.33

LONG-TERM FINANCING IN MANUFACTURING OF COMMERCIAL BANKS, BY PRODUCT, 1981-1990 1/

(Growth Rates)

Product	1981 a/	1982	1983 b/	1984	1985	1986	1987	1988	1989	1990	Average
Food, beverage and tobacco	-3.1	-53.1	-0.5	-30.1	95.2	51.6	-54.8	29.2	-46.2	-18.8	-3.1
Textile, wearing apparels & leather	-62.3	105.6	-25.4	9.0	-44.7	41.7	-49.2	-32.3	-59.0	274.2	15.9
Wood and wood products (including furniture)	69.4	16.1	-88.3	61.3	57.8	-59.8	-5.5	-19.5	-28.5	237.1	24.0
Paper and paper products (including printing)	-75.5	79.9	-44.6	78.7	-3.9	20.4	-10.7	-3.4	-48.9	-46.8	-5.5
Chemicals, petroleum, coal & rubber	-32.4	55.4	-50.5	272.6	-70.4	12.5	-6.3	-46.5	31.5	23.1	18.9
Non-metallic minerals	89.8	1.4	91.4	-74.1	25.0	-41.2	-95.5	-	-60.6	57.7	-0.6
Basic metals	-81.5	-	23.2	-45.4	181.8	-22.8	-35.8	971.2	-14.5	-49.7	92.7
Fabricated metals	-31.5	0.6	0.2	67.8	-51.2	71.1	-41.1	-75.4	-90.6	379.7	23.0
Other manufacturing products	67.0	-53.6	413.4	-60.6	47.7	-67.4	-	-86.8	238.4	-44.4	45.4
Total	-37.8	66.6	-58.4	3.6	0.8	35.3	-32.1	07	-30.5	-16.9	-4.9

1 As of 1990, commercial banks supplied around 79 percent of aggregate long-term financing for the manufacturing sector.

– Less than 0.1 percent.

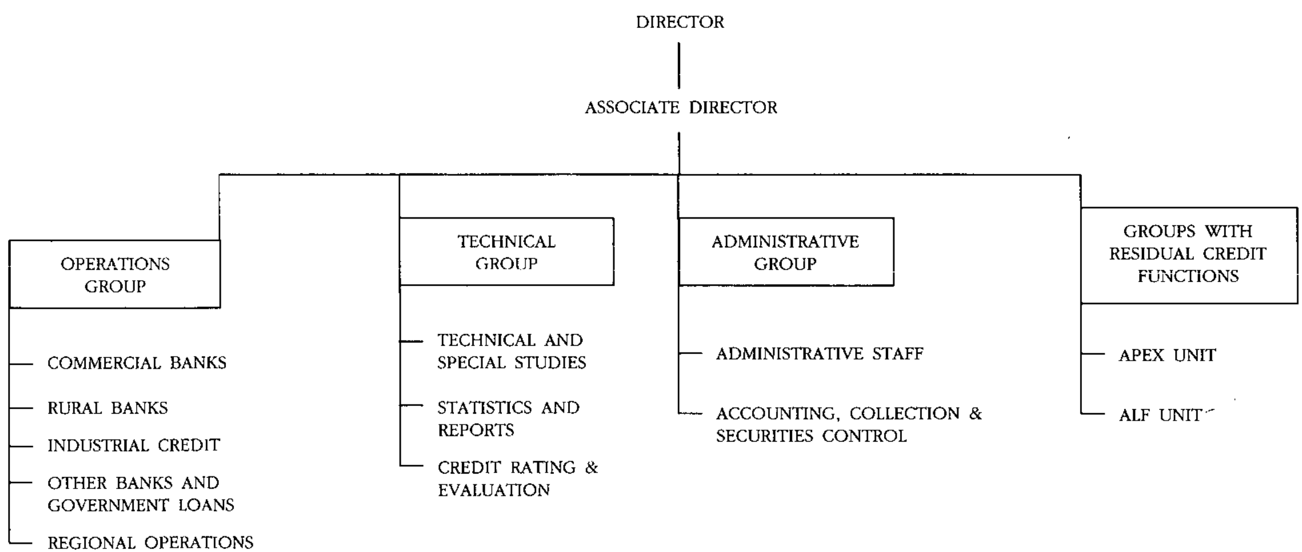
a Based on 1st quarter 1982 data.

b Based on 1st quarter 1984 data.

Source: DER-Domestic, Central Bank of the Philippines.

ORGANIZATIONAL CHART

DEPARTMENT OF LOANS AND CREDIT
CENTRAL BANK OF THE PHILIPPINES



Bibliography

1. Central Bank of the Philippines, *Agricultural Credit Handbook,* Supervision and Examination Sector, Manila, 1978.

2. ____________________, *Annual Report (Volumes I and II),* Manila, various years.

3. ____________________, *Annual Report, Department of Loans and Credit,* Manila, 1990.

4. ____________________, *Fact Book: Philippine Financial System,* Supervisory Report and Corporate Analysis Department, Manila, various years.

5. ____________________, *The Philippine Rural Banking System,* Manila, various years.

6 ____________________, *Term Lending Handbook,* Supervision and Examination Sector, Manila, 1980.

7. Cintura, Antonio, Myrna Putong, and Fernando Silvoza, "What Keeps Unibanks From Investing in Non-Allied Undertakings?", *CB Review,* Manila, November, 1990.

8. National Statistical Coordination Board, *Philippine Statistical Yearbook,* Manila, various years.

9. Philippine Deposit Insurance Corporation, *Financial Schemes Available to the Philippine Countryside,* Manila, 1972, Third Edition.

Chapter 11

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN SRI LANKA

by

D.J.G. Fernando

I. An Overview of the Existing Conditions of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1 Nature of Long-Term Financing for Manufacturing and Agricultural Sectors

1.1.1 Overview

Investment is widely accepted as a prime requirement for economic growth. In order to make investment a reality and its use more productive an economy has to channel investable funds, especially long-term finance via financial intermediaries in an efficient manner. In Sri Lanka, since obtaining political independence from the British rule in 1948 successive governments have attempted to expedite the pace of economic growth by promoting long-term finance towards productive investment, mainly for manufacturing and agricultural sectors.

In Sri Lanka, commercial banks and two development banks, namely the Development Finance Corporation of Ceylon (DFCC) and the National Development Bank (NDB) act as a major institutional sources of long-term funds[1] for manufacturing and agriculture. Presently, the commercial banking system consists of domestic banks including two state banks and four private banks, and sixteen foreign banks. However, in terms of assets and the number of island-wide branch network, domestic commercial banks dominate the market. Hence, they are responsible for the bulk of long-term credit extended for the two sectors mentioned above. The DFCC established in 1955 and the NDB started in 1979 have also registered a considerable increase in their long-term lending, especially to manufacturing/industrial purposes in recent years.

---

1. Long-term funds (loans) are defined as loans with maturities of more than five years.

Apart from the above institutions, merchant banks and leasing companies also engage in a limited way in long-term financing. The reliance of the private sector on capital market for long-term finance has been rather low, while the government through its substantial investment in infrastructure has contributed to the long-term development of both sectors since independence in 1948.

As evident from Table 11.1, of the long-term credit provided by commercial banks, the DFCC and the NDB during the period 1980-1990, the absorption by manufacturing and agricultural sectors has been significant. For instance, on average 46 per cent of total long-term finance was utilised by the manufacturing sector, while that of the agricultural sector was 11 per cent during the period. When long-term, medium- and short-term or total finances for the two sectors are expressed as a percentage of total financing (i.e. for all purposes), the share of agricultural loans during the period 1980 to 1990 was 9 per cent, while that of the manufacturing loans stood at 30 per cent.

To analyse the significance of long-term financing for manufacturing and agricultural sectors, we propose to express such credit as a percentage of GDP, total exports and value added in the two sectors mentioned above, during the period 1980-1990. As displayed in Table 11.2, the share of long-term finance for both sectors between 1980 and 1990 has remained between 0.48 per cent and 1.26 per cent of the GDP, while the average for the period was 0.87 per cent. Meanwhile, when expressed as a percentage of total exports and value added in two sectors, long-term financing for both sectors were 3.58 per cent and 2.05 per cent, respectively on an annual average basis during the period 1980-1990.

1.1.2 Contribution of the Manufacturing and Agricultural Sectors Towards GDP and Exports

During the past decade the agricultural and manufacturing sectors have been responsible for about 40-45 per cent of the gross domestic product (GDP). In Sri Lanka, agricultural sector consists of tea, rubber, coconut, paddy, subsidiary food crops, forestry and fishing. The manufacturing sector includes export processing of tea, rubber and coconut, factory industries, small industries and other industrial activities.

As shown in Table 11.3 although the share of agriculture has declined marginally during the last decade, it still influences the growth of GDP in a substantial way. For instance, growth rates in agriculture and GDP have more or less moved in the same direction in the past. Meanwhile,

Table 11.1

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS 1/

(Approvals/Change - in Million Rupiah)

Year	Long Term Financing			Total Financing			A/D	B/E	C/F
	Agri. (A)	Mfg. (B)	All Sectors (C)	Agri. (D)	Mfg. (E)	All Sectors (F)			
1980	103 (8)	410 (31)	1312	907 (16)	554 (10)	5725	11	74	22
1981	7 (1)	521 (42)	1249	506 (11)	1751 (39)	4433	1	29	28
1982	8 (1)	438 (72)	612	278 (6)	1897 (40)	4764	2	23	12
1983	137 (14)	499 (52)	954	434 (7)	2291 (34)	6667	32	22	14
1984	136 (9)	954 (65)	1469	-32 (-1)	1395 (31)	4466	425	68	33
1985	194 (11)	914 (51)	1797	172 (4)	1273 (29)	4463	116	72	40
1986	360 (15)	1141 (48)	2366	731 (17)	1376 (32)	4348	50	83	54
1987	848 (23)	1042 (28)	3749	1020 (11)	1875 (20)	9330	83	56	40
1988	521 (13)	2054 (51)	4024	650 (6)	4543 (40)	11272	80	45	36
1989	577 (11)	2161 (42)	5146	856 (7)	4673 (40)	11659	67	46	44
1990	644 (10)	2541 (39)	6572	3140 (18)	2465 (14)	17682	20	59	37

Note: Figures in brackets represent the share of that sector in all sector total.

1 Approved amounts by the Development Finance Corporation of Ceylon and the National Development Bank, and change in long-term outstanding credit of commercial banks during the year.

Source: Central Bank of Sri Lanka, *Annual Reports and Monthly Bulletins.*

Table 11.2

RATIO OF LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS TO GDP, TOTAL EXPORTS AND VALUE ADDED IN THE TWO SECTORS

(Value in Million Rupiah)

Year	Aggregate Long term Financing for the 2 Sectors (approvals/ change) (A)	GDP (B)	Total Exports (C)	Value Added in the Two Sectors (D)	A/B	A/C	A/D
1980	513	62,246	17,595	28,199	0.82	2.92	1.82
1981	528	79,337	21,043	34,860	0.67	2.51	1.51
1982	446	93,194	21,454	38,565	0.48	2.08	1.16
1983	636	111,976	25,096	48,138	0.57	2.53	1.32
1984	1,090	138,173	37,347	62,038	0.79	2.92	1.76
1985	1,108	148,321	36,207	62,918	0.75	3.06	1.76
1986	1,501	163,713	34,072	69,224	0.92	4.41	2.17
1987	1,890	177,731	41,133	76,393	1.06	4.59	2.47
1988	2,575	203,516	46,928	84,898	1.26	5.49	3.03
1989	2,738	228,138	56,175	93,403	1.20	4.87	2.93
1990	3,185	290,495	79,481	119,632	1.10	4.01	2.66

Source: Central Bank of Sri Lanka, *Annual Reports and Reviews of the Economy.*

Table 11.3

CONTRIBUTION OF AGRICULTURAL AND MANUFACTURING SECTORS TO GROSS DOMESTIC PRODUCT (1980-1990)

(At Current Factor Cost Prices)

Year	GDP (Rs. Mn)	Agriculture 1/ (Rs. Mn)	Manufacturing (Rs. Mn)	Percentage in GDP	
				Agriculture	Manufacturing
1980	62,246	17,151	11,048	28	18
1981	79,337	21,977	12,883	28	16
1982	93,194	24,964	13,601	27	15
1983	111,976	32,180	15,958	29	14
1984	138,173	41,148	20,890	30	15
1985	148,321	41,069	21,849	28	15
1986	163,713	44,355	24,869	27	15
1987	177,731	47,923	28,470	27	16
1988	203,516	53,600	31,298	26	15
1989	228,138	58,462	34,941	26	15
1990	290,495	76,504	43,128	26	15

1 Including Forestry and Fishing.

Source: Central Bank of Sri Lanka, *Annual Reports*.

the share of manufacturing sector in GDP has remained rather static in the recent past, contributing about 15 per cent of the GDP. Among other factors, the usual problems associated with long-term credit may have been an important factor responsible for this situation. It is also worth noting that the government of Sri Lanka has identified this sector in its investment programme for the period 1990-1994 in view of the capacity of the manufacturing sector to raise employment avenues and exports.

The contribution of agricultural and manufacturing sectors to the economy is prominent when the structure of exports is considered. For instance, as shown in Table 11.4, the two sectors have been responsible for about 90 per cent of the total export earnings during the period 1980-1990. It is also worth noting that manufacturing exports have expanded sharply during this period. Consequently, the share of agricultural exports in total exports has declined from 61.8 per cent to 36.3 per cent, while that of the manufacturing has expanded from 33 per cent to 52.2 per cent during the same period. Furthermore, agricultural and manufacturing exports on an annual average basis have increased by 11 per cent and 26 per cent, respectively during the period 1980-1990. The growth in total exports during this period was 17 per cent.

Table 11.4

CONTRIBUTION OF THE AGRICULTURAL AND MANUFACTURING EXPORTS TO TOTAL EXPORTS

(Value Rs. Mn)

Year	Exports					Rate of Increase		
	Agriculture	Percentage Share in Total Exports	Manufacturing	Percentage Share in Total Exports	Total	Agriculture	Manufacturing	Total
1980	10,873	(61.8)	5,814	(33.0)	17,575	0.7	57.1	15.0
1981	12,170	(57.8)	7,296	(34.7)	21,043	11.9	25.5	19.7
1982	11,656	(54.3)	8,271	(38.6)	21,454	-4.2	13.4	1.9
1983	14,554	(58.0)	8,821	(35.1)	25,096	24.9	6.6	17.0
1984	22,575	(60.4)	12,918	(34.6)	37,347	55.1	46.4	48.8
1985	19,026	(52.5)	14,295	(39.5)	36,207	-15.7	10.7	-3.1
1986	15,764	(46.3)	15,878	(46.6)	34,072	-17.1	11.1	-5.9
1987	17,437	(42.4)	20,004	(48.6)	41,133	10.6	26.0	20.7
1988	20,104	(42.8)	22,674	(48.3)	46,928	15.3	13.3	14.1
1989	22,049	(39.2)	28,470	(50.7)	56,175	9.7	25.6	19.7
1990	28,852	(36.3)	41,510	(52.2)	79,481	30.8	45.8	41.5

Source: Central Bank of Sri Lanka, *Annual Reports*.

Meanwhile, Sri Lanka Export Development Board in its National Export Development Plan 1990-1994 has highlighted three major reasons for export promotion. First, since exports contribute to the GNP, the expansion in exports results in increasing GNP and per capita income. Second, the production of exportable items for a larger market (i.e. World Market) will achieve economies of scale and lead to a decline in cost of production per unit. Third, the promotion of exports is a viable solution for the balance of payments deficits that the economy is experiencing during the last decade.

1.1.3 Long-Term Financing for Manufacturing and Agricultural Sectors by Product/Use

When long-term financing for manufacturing by the DFCC and NDB is disaggregated, it is evident that the share of metals and engineering sector has increased since 1980 to reach 69 per cent by 1989 (Table 11.5). Similarly, the share of other manufacturing has declined from 49 per cent to 9 per cent during the period. Also, the share of long-term credit (approvals) for engineering and building trade has shown a declining trend during the last decade. Meanwhile, during the period 1980-1989 of the total long-term financing (Rs 8.7 billion) for manufacturing purposes, 27 per cent has been absorbed by metals, chemicals and engineering sector, while the share of other manufacturing was 26 per cent.

Table 11.6 shows the long-term financing (approvals) for agriculture extended by the DFCC and NDB to the agricultural sector by product. The plantation sub sector consists mainly of tea, rubber and coconut, received 66 per cent of total financing during the period 1980-1989, while livestock sub-sector received 17 per cent during the same period. Long-term financing extended to domestic agriculture mainly consists of paddy and other domestic food crops has been limited to a single year and represented only 5 per cent of the total approval between 1980 and 1989.

Long-term financing for both sectors extended by commercial banks by product during the period 1988-1990 is shown in Table 11.7. With respect to manufacturing loans (apart from other manufacturing or unclassified), the sub-sector of engineering and building trade has obtained a substantial part of the total manufacturing lending (29-45 per cent). Meanwhile, of the agricultural long-term finance, the sub-sector has utilised a substantial amount of the total (more than 80 per cent) during the period mentioned above.

Table 11.5

LONG-TERM FINANCING (APPROVALS) FOR THE MANUFACTURING SECTORS BY PRODUCT 1/

(Million Rupiah)

Sector	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1980-1989
Mechanical Processing of Plantation Crops	14	4	39	94	88	18	50	28	278	-	613
	(3)	(1)	(11)	(22)	(11)	(3)	(5)	(3)	(19)	(-)	(7)
Mechanical Processing of Agricultural Crops	12	24	42	150	35	45	114	102	-	-	524
	(3)	(6)	(12)	(35)	(4)	(6)	(10)	(11)	(-)	(-)	(6)
Engineering & Building Trade	212	104	7	6	125	79	109	149	15	14	820
	(45)	(27)	(2)	(1)	(15)	(11)	(10)	(16)	(1)	(1)	(9)
Mining	-	-	-	..	-	7	-	2	28	22	59
	(-)	(-)	(-)	(..)	(-)	(1)	(-)	(..)	(2)	(1)	(1)
Food, Beverage and Tobacco	-	-	-	-	-	131	276	179	276	179	1041
	(-)	(-)	(-)	(-)	(-)	(18)	(25)	(19)	(19)	(9)	(12)
Textile and Wearing Apparel	-	-	-	-	-	90	97	172	132	110	601
	(-)	(-)	(-)	(-)	(-)	(13)	(9)	(18)	(9)	(5)	(7)
Rubber and Leather Products	-	-	-	-	-	51	92	61	140	132	476
	(-)	(-)	(-)	(-)	(-)	(7)	(8)	(7)	(9)	(6)	(5)
Metals, Chemicals and Engineering	-	-	-	-	-	100	133	156	542	1417	2348
	(-)	(-)	(-)	(-)	(-)	(14)	(12)	(17)	(37)	(69)	(27)
Other Manufacturing	230	251	256	180	574	193	227	88	57	172	2228
	(49)	(66)	(75)	(42)	(70)	(27)	(21)	(9)	(4)	(9)	(26)
TOTAL	468	383	344	430	822	714	1098	937	1468	2046	8710
	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)

Note: Percentage share is shown in brackets.

1 By DFCC and NDB.

Source: Central Bank of Sri Lanka, *Annual Reports and Annual Reviews of the economy.*

Table 11.6

LONG-TERM FINANCING (APPROVALS) FOR AGRICULTURAL SECTOR BY PRODUCT 1/

(Million Rupiah)

Year	Plantation	Domestic	Livestock	Fishing	Total
1980	-	-	-	-	-
1981	-	-	-	-	-
					(100)
1982	1	-	-	-	1
	(100)				(100)
1983	5	-	1	-	6
	(83)	-	(17)	-	(100)
1984	-	-	1	-	1
	-	-	(100)	-	(100)
1985	17	-	1	-	18
	(94)	-	(6)	-	(100)
1986	4	12	26	12	54
	(8)	(22)	(48)	(22)	(100)
1987	23	-	4	4	31
	(74)	-	(13)	(13)	(100)
1988	26	-	-	-	26
	(100)	-	-	-	(100)
1989	85	-	8	14	107
	(79)	-	(8)	(13)	(100)
1980-1989	161	12	41	30	244
	(66)	(5)	(17)	(12)	(100)

Note: Percentage share is shown in brackets.

1 By the DFCC and NDB.

Source: Central Bank of Sri Lanka, *Annual Reviews of the Economy and Annual Reports.*

Table 11.7

COMMERCIAL BANK LONG-TERM FINANCING 1/ FOR MANUFACTURING AND AGRICULTURAL SECTORS BY PRODUCT

(Million Rupiah)

Sector/Product	1988		1989		1990	
	Amt	% of Total	Amt	% of Total	Amt	% of Total
A) Manufacturing Sector						
A.1 Mechanical Processing of Tea, Rubber and Coconut	6	1	6	5	35	6
A.2 Mechanical Processing of Other Agricultural Commodities	52	9	-35	-30	21	4
A.3 Engineering and Building Trade	264	45	..	..	179	29
A.4 Mining and Fishing	-2	..	-11	-10	-35	-6
A.5 Other Manufacturing	268	45	155	135	410	67
Total	588	100	115	100	610	100
B) Agricultural Sector						
B.1 Tea	406	82	467	99	471	84
B.2 Rubber	-3	-1	1	..	1	..
B.3 Coconut	..	..	1	..	-2	..
B.4 Paddy	37	8	-13	-3	9	1
B.5 Other agricultural crops (including Livestock & Dairying)	55	11	15	4	83	15
Total	495	100	471	100	562	100

1 Change in outstanding value.

Source: Central Bank of Sri Lanka, *Monthly Bulletins*.

1.1.4 Other Institutions Involved in the Financing of the Two Sectors

Apart from the institutions mentioned earlier, there are several financial institutions involved in the financing and development of manufacturing and agricultural sectors in a limited manner. Such institutions are represented by the National Savings Bank (NSB), State Mortgage and Investment Bank (SMIB), leasing companies and merchant banks.

The medium- and long-term credit approved by the NSB for agriculture during the period 1986-1989 has been less than Rs. 7 million per year and represented less than 3 per cent of its total annual approval. Also, during the period 1986-1988 the NSB had approved some industrial (manufacturing)loans which represented about 2-7 per cent of its total approval during the period. Meanwhile, the SMIB has not approved any manufacturing loans during the period 1984-1989, while its agricultural loans have remained between 1 to 3 per cent of its total approval during this period.

Leasing companies were introduced in Sri Lanka in 1981. Through leasing arrangements they have provided machinery and equipment needed by the sectors for medium and long-term periods. Presently, there are three leasing companies, namely Lanka. Orix Leasing Company, Mercantile Leasing Company and Commercial Leasing Company. The total assets of these companies by 1990 amounted to Rs. 463 million representing a small fraction of assets of commercial banks and other long-term lending institutions. However, bulk of the leasing operations of these companies are concentrated on manufacturing activities. Meanwhile, it is worth noting some of the problems faced by leasing companies in expanding their activities towards long-term financing. For instance, as the Chairman of the Mercantile Leasing Limited stated in the Report and Accounts 1990/91 of the company, "The leasing industry continues to receive step motherly treatment when compared to other forms of financing. Leasing is penalised by ways of higher turn over tax and stamp duty when compared to bank loans. .... Leasing companies continue to be excluded from the benefits of the Debt Recovery Act and also have been left out as a participating institution in the formation of the Credit Bureau" (p.4).

Merchant banks in Sri Lanka also provide long-term financing mainly in the form of leasing activities to facilitate industrial activities in a limited manner. Presently there are three merchant banks, namely Merchant Bank of Sri Lanka Limited, People's Merchant Bank and Mercantile Merchant Bank. On the other hand, merchant banks indirectly promote manufacturing and agricultural investment. However, as in the case of leasing companies the total assets of merchant banks at the end of 1990 have been less than Rs. 200 million.

1.2 Sources of Long Term Financing

The major sources of institutional long-term financing to the agricultural and manufacturing sectors are the DFCC, NDB and commercial banks, especially the two state banks and four domestic private banks. As shown in Table 11.8, commercial banks have been the major source of long-term finance for agriculture during the last decade, while indi-

Table 11.8

LONG-TERM FINANCING TO THE AGRICULTURAL AND MANUFACTURING SECTORS BY INSTITUTION

(Approvals in Million Rupiah)

Sector/Year	DFCC		NDB		Commercial Banks 1/		Total	
	Amt	% of Total	Amt	% of Total	Amt	% of Total	Amt	% of Total
Agriculture								
1980	-	-	-	-	103	100	103	100
1985	13	7	-	-	181	93	194	100
1990	37	6	45	7	562	87	644	100
Manufacturing								
1980	96	24	285	70	29	7	410	100
1985	257	28	565	62	92	10	914	100
1990	836	33	1095	43	610	24	2541	100
All Sectors								
1980	139	11	364	28	809	61	1312	100
1985	370	21	828	46	599	33	1797	100
1990	1295	20	1901	29	3376	51	6572	100

1 Annual change in outstanding amount.

Source: Central Bank of Sri Lanka, *Annual Reports.*

vidual shares of the DFCC and NDB have been less than 10 per cent of total agricultural (long-term) financing.

Conversely, in the case of long-term manufacturing financing, the share of commercial banks has been less than a third of the total manufacturing credit by all institutions. However, the share has shown an increasing trend during the period 1980-1990. Although the role has been on the decline, still the NDB performs as the major individual source of long-term manufacturing finance in Sri Lanka. The substantial engagement in small- and medium-scale industrial long-term financing by the NDB can be highlighted as the main reason for this situation. Meanwhile, the DFCC slowly but steadily has enhanced its share in manufacturing financing during the decade ended 1990. It is also worth noting that the combine share of long-term financing for all sectors by the DFCC and NDB has risen from 39 per cent in 1980 to 49 per cent in 1990.

The main sources of funds of the National Development Bank (NDB) which provided the bulk of its long-term credit for industrial purposes in the recent past consisted of income generated from its operations, loans received from the government of Sri Lanka and the Central Bank, and repayment by borrowers. The portfolio sales and other sources of funds have accounted for less than 5 per cent of the total resources of the NDB since 1988. The funds generated from operations represented net income before taxes and non cash charges to income. The loans received from the government were in the form of direct loans, while loans from the Central Bank were in the form of refinance. As shown in Table 11.9, the share of loans has accounted for half of the total sources of the long-term financing of the NDB in 1990, while the importance of repayments by borrowers has declined over time.

The sources of funds of the Development Finance Corporation of Ceylon (DFCC) are shown in Table 11.10. They consist of funds generated from operations, recoveries from project investments, long-term borrowings, and others. In contrast to the NDB, the share of long-term borrowings (or loans received) as a source of funds of the DFCC has declined from 44 per cent in 1988 to 36 per cent by the end of 1990. On the other hand, the contribution of recoveries from project investment has risen from 41 per cent to 47 per cent during the period under review. However, it has to be noted that the total fund requirement of the NDB has been greater than that of the DFCC in the

Table 11.9

SOURCES OF FUNDS OF THE NATIONAL DEVELOPMENT BANK (NDB)

(In Million Rupiah)

Source	End 1988		End 1989		End 1990	
	Amt	% of Total	Amt	% of Total	Amt	% of Total
1. From Operations	204	19.7	241	18.5	413	15.4
2. Loans received from Government and Central Bank	322	31.2	449	34.5	1361	50.7
3. Repayment by Borrowers	470	45.5	555	42.7	792	29.5
4. Portfolio Sales	-	-	1	0.1	6	0.2
5. Others	37	3.6	55	4.2	111	4.1
Total	1033	100	1301	100	2683	100

Source: National Development Bank, Report and Accounts (1988-1990).

past. Meanwhile, recoveries from project investments consisted of loan recoveries, amortisation of leases and sale/redemption of shares held by the DFCC.

The sources of funds of commercial banks are indicated in Table 11.11. In contrast to the two long-term development financial institutions (NDB and DFCC) mentioned above, commercial banks mobilise their resources mainly through deposits. Also the resource base of commercial banks is several times higher than that of the NDB and DFCC taken together. Furthermore, even the amount of time/fixed deposits of banks which are used as the base of long-term lending amounted to Rs 36 billion and can be compared with the total resources of nearly Rs 4 billion of the NDB and DFCC in 1990. It is also worth noting that the long-term refinance received by commercial banks under the MLCF of the Central Bank has increased substantially since 1988. For instance, such funds which expanded from Rs 777 million to Rs 1503 million between 1988 and 1990 can be compared with the total resources of Rs 2683 million and Rs 1108 million of the NDB and DFCC respectively by 1990.

Table 11.10

SOURCES OF FUNDS OF THE DEVELOPMENT FINANCE CORPORATION OF CEYLON (DFCC)

(In Million Rupiah)

Source	End March 1988		End March 1989		End March 1990	
	Amt	% of Total	Amt	% of Total	Amt	% of Total
1. From Operations	102	14.3	125	13.2	178	16.1
2. Recoveries from Project Investment	291	40.9	364	38.4	525	47.4
3. Long Term Borrowings	314	44.1	458	48.3	402	36.3
4. Others	5	0.7	1	0.1	3	0.2
Total	712	100	948	100	1108	100

Source: *Development Finance Corporation of Ceylon, Report and Accounts (1988-1990).*

Table 11.11

SOURCES OF FUNDS OF COMMERCIAL BANKS

(In Million Rupiah)

Source	End 1988		End 1989		End 1990	
	Amt	% of Total	Amt	% of Total	Amt	% of Total
1. Deposits	61672	64.9	71693	68.1	90549	70.3
Demand	18313	19.3	21439	20.4	26885	20.9
Savings	17991	18.9	22513	21.4	27312	21.2
Time/Fixed	25388	26.7	27741	26.3	36352	28.2
2. Capital and Resources	4774	5.0	5395	5.1	6690	5.2
3. Refinance Credit from Central Bank	3469	3.7	3878	3.7	4393	3.4
Short Term	2695	2.9	2706	2.6	2890	2.2
Under MLCF	774	0.8	1172	1.1	1503	1.2
4. Other Liabilities	25074	26.4	24253	23.1	27143	21.1
Total	94989	100	105219	100	128775	100

Source: Central Bank of Sri Lanka, Monthly Bulletins.

1.3 Lending Policies and Procedures

In Sri Lanka at macro level policy making, lending to manufacturing and agricultural sectors has been considered priority lending during the last decade. For instance, tax exemptions have been offered, while lending to the two sectors has been extended from the credit ceilings imposed by the Central Bank of Sri Lanka from time to time. However, it appears that there has been no specific policy with respect to interest rates associated with long-term lending. In fact, with the increase in short-term savings rates several financial institutions have found it difficult to raise long-term funds at reasonable rates. On the other hand, the enhancement of short-term savings rates, especially in the wake of price inflation has led to a considerable increase in nominal lending rates which seem to have affected the demand for long-term finance. As stated by the Chairman of the NDB in the Report and Accounts - 1990 of the NDB, "I mentioned that interest rates in Sri Lanka had risen considerably in 1989 and expressed the hope that these rates would start to decline again in 1990. Unfortunately, this hope was not realised. On the contrary, interest rates rose further in 1990 .... Commercial Banks have, in turn, increased their own borrowing and lending rates. The cost of funds borrowed by the NDB for lending rose during 1990 and the Bank was therefore compelled to increase its own lending rates to its clients .... This would reduce the volume of borrowing and investment in the economy and thereby curtail the growth of production and employment" (p.21). A similar view has been expressed by the Chairman of the DFCC in the Report and Accounts of 1989-90 (see p. 16).

Meanwhile, the Debt Recovery Act passed by the Parliament of Sri Lanka in early 1990 together with amendments to the other separate Acts relating to debt recovery has helped to reduce the high cost and longer time associated with debt recovery. These Acts apply to licensed commercial banks, State Mortgage and Investment Bank, National Development Bank, National Savings Bank, Development Finance Corporation of Ceylon and Finance Companies registered under the Finance Companies Act No. 78 of 1988. Under the Debt Recovery Act, the above lending institutions after obtaining the Decree Nisi from court can service the Decree Nisi by registered post thus facilitating the speedy recovery of loans. Furthermore, a Credit Information Bureau came into operation from May, 1990 as an important step to strengthen, especially the lending activities of financial institutions including commercial banks, NDB, NSB, DFCC, and SMIB.

Regarding lending procedures of long-term financing institutions (commercial banks, NDB and DFCC) their decisions to finance projects are done through careful appraisal of the technical, financial, economic, management and other relevant aspects of the project. With respect to equity financing as a general rule the total equity investments should not exceed the institutions own equity. Also some long-term lending institutions have placed limits on equity finance based on their total outstanding borrowing.

In case of loans extended for manufacturing and agricultural purposes maximum exposure to a project is usually less than two thirds of the total cost of project. The exchange risk of the foreign currency loans of the NDB and DFCC is borne by the government.

II. The Role of the Central Bank in Long-Term Financing for the Manufacturing and Agricultural Sectors

2.1 Financing

2.1.1 Financing Facilities of the Central Bank

Since its establishment, the Central Bank of Sri Lanka has been actively involved in strengthening the institutional framework for long-term finance as well as providing the necessary financial assistance for medium- and long-term ventures. In this regard, having identified the importance of providing adequate resources at reasonable costs for productive long-term investment, the Central Bank of Sri Lanka (then known as the Central Bank of Ceylon) established the Medium and Long-Term Credit Fund (MLCF) in July 1964, under the section 88 E of the Monetary Law Act (MLA) which governs the activities of the Bank. As the Central Bank (1990) observed, the need to engage in promoting medium and long-term lending was foreseen in the Exter Report.[2] By providing its own finance (refinance facilities) through commercial banks and other participating institutions, the Central Bank induces such financial intermediaries to actively engage in productive medium- and long-term lending under certain stipulated conditions with respect to amounts and lending rates.

---

2. Report on the Establishment of a Central Bank for Ceylon, Sessional paper, November 1949, p.7.

At the outset (1964), the Central Bank allocated a minimum sum of Rs. 100 million for this fund, and subsequently has augmented the resources of the MLCF through periodic transfers of funds. Presently, an amount of Rs. 3250 million is available for medium- and long-term lending under the MLCF. By the end of 1990, the outstanding utilisation of funds amounted to Rs. 2545 million. The approval of funds under the MLCF for agricultural and industrial (manufacturing) purposes in selected years are shown in Table 11.12.

2.1.2 Credit Guarantee Schemes

As in most developing countries, a major problem especially faced by small- and medium- size borrowers in obtaining long-term credit for agriculture and manufacturing is their inability to provide acceptable securities against borrowings. Having identified this problem, to facilitate long-term lending, the Central Bank of Sri Lanka in 1978 introduced a credit guarantee scheme under the Small Scale Industries (SSI) scheme in collaboration with the Industrial Development Board. The Central Bank guaranteed 75 per cent of the loans granted through the two state banks and the DFCC. This scheme was completed by 1981 and covered 767 loans amounting to Rs. 31 million in which Rs. 23 million was guaranteed by the Central Bank of Sri Lanka.

Table 11.12

APPROVALS OF REFINANCE FOR AGRICULTURE AND INDUSTRY (MANUFACTURING) UNDER THE MLCF

(Rs. Million)

Year	Agriculture	Industry	Total
1980	0.7	49.0	49.7
1983	19.2	7.0	26.2
1986	80.6	0.6	81.2
1988	43.2	1.7	44.9
1989	8.8	21.2	30.0
1990	-	72.6	72.6

Source: Derived from Central Bank Annual Reports.

Since 1979 the Central Bank has provided guarantee facilities for medium and long-term loans obtained under three loan facilities provided by the International Development Association (IDA) for Small and Medium Scale Industries (SMI). The National Development Bank distributes the loans under this scheme for participating institutions including the commercial banks.

Under the SMI - I Scheme (1979-1982), 1670 guarantees were issued to cover loans amounting Rs. 286 million, while under the SMI-II scheme (1982-1989), 2531 loans were guaranteed to cover loans amounting Rs. 1392 million. Meanwhile, under the SMI-III (which commenced in 1988), 2340 loans amounting Rs. 1383 million have been guaranteed by the end of 1990.

2.1.3 Credit Planning

The active role of the Central Bank of Sri Lanka in promoting medium and long-term credit, especially for agricultural and manufacturing purposes is also reflected through its planning of credit extended by commercial banks and major long-term lending institutions introduced in 1981. Initially, the coverage of this exercise was limited to commercial banks, while since 1986 the coverage has been extended also to include the National Savings Bank, National Development Bank, and State Mortgage and Investment Bank. Through credit planning, the above financial institutions were requested to raise their medium- and long-term lending for productive and priority sectors including agriculture and manufacturing.

2.2 Regulations

As in the case of other refinance schemes operated by the Central Bank, the regulations governing the MLCF have been stipulated and are subjected to changes based on existing monetary policies of the Central Bank from time to time. For instance, the purposes of funds available under the MLCF together with current ratios of refinance, associated interest rates and lender's margins are indicated below.

a) Promotion or Development in agriculture and fisheries approved by respective ministries carrying tax holidays - 100 per cent refinance is available at 9 per cent per annum with a lender's margin of 7 percentage points.

b) Promotion of Development of exports 80 per cent refinance is available at 7 per cent for loans not exceeding Rs. 5 million, while 80 per cent refinance is available at 8 per cent per annum with a lender's margin of 4 percentage points.

c) Approved investments (including manufacturing) carrying tax holidays and investments in agriculture and fisheries outside the schemes approved by the Ministries - 60 per cent refinance is available at 10 per cent per annum with a lender's margin of 4 percentage points.

d) Other productive purposes (including manufacturing) - 60 per cent refinance is available at 12 per cent per annum with a lender's margin of 4 percentage points.

The above rates can be compared with the current prime lending rate of about 20 per cent per annum of commercial banks and their maximum lending rates for different purposes of around 25-35 per cent per annum.

2.3 Supervision

In a broader sense, the Development Finance Department of the Central Bank is responsible for the evaluation of long-term loans made available under the MLCF. The loans have to be approved by the Monetary Board of the Central Bank. The loans granted under the MLCF are supervised by several institutions. First, they are supervised by the lending institutions other than the Central bank. Second, the Central Bank directly supervises the long-term loans granted to commercial banks during its periodic and continuous examinations. Thirdly, any demand for rescheduling of problematic loans of other long-term lending institutions are examined in detail when such requests are made by the institutions such as the National Development Bank and the Development Finance Corporation of Ceylon.

The high level of supervision carried by the above two institutions on their lending is also reflected by the very low default rates of loans. For instance, as reported by the National Development Bank (the largest long-term lender for industry) in its Annual Report (1990), "NDB's loan portfolio is now in a very healthy state, with collection ratios on loan and interest dues at around 91 per cent, a rate much higher than in most Development Banks in Asia" (p.23).

2.4 Implications for the Central Bank

Since the Central Bank does not engage directly in long-term lending for agriculture and manufacturing the risk of defaults is not borne by the Bank. The risk of proper collection rests with participating lending institutions, including commercial banks, the NDB and the DFCC.

However, refinance credit extended by the Central Bank under the MLCF has emerged as a major item in total refinance as well as monetary base. For instance, the outstanding medium and long-term credit which accounted for 32 per cent of total refinance credit by the end of 1988 has increased to 36 per cent by the end of 1990. Similarly, between the end of 1988 and the end of 1990 refinance loans by the Central Bank as a percentage by the monetary base has increased from 15 per cent to 23 per cent thus became a major causal factor of monetary base and hence monetary expansion. Furthermore, the availability of Central Bank resources for long-term investment may have discouraged investors to raise such funds from the capital market and affected negatively the development of an active stock market in the past.

III. Issues and Suggestions in Long Term Financing for the Manufacturing and Agricultural Sectors

3.1 Factors Limiting Access to Institutional Credit

As a low income[3] developing economy, in Sri Lanka there are several constraints which limit the access of institutional credit for the manufacturing and agricultural sectors. Firstly, most of the ventures are small and medium type organisations based on private ownership. They seldom rely on capital markets for funds, and hence as the two major sectors in the economy both sectors under review have to depend heavily on institutional finance for long-term investment. This factor itself exerts pressure on limited long-term funds of the two development banks and commercial banks. Secondly, an associated factor is that the extensive use of long-term finance by the government for its budgetary purposes limits the availability of such funds for private investment in both sectors. However, the substantial use of long-term funds by the government reduces the funds available for long-term lending by the above

3. The per capita income in Sri Lanka, according to the World Development Report (1991) stood at US$ 430 in 1989.

institutions. For instance, by the end of 1990 the use of long-term resources (outstanding) by the government amounted to Rs. 61 billion, and this can be compared with total approval of Rs. 16 billion as long-term financing for the two sectors during the period 1980-1990 (Table 11.1). The details of government borrowing of long-term finance as at the end of 1990 from institutional sources are shown below:

Institution	Outstanding Amount (Million Rupiah)
Employee's Provident Fund	34,597
Employee's Trust Fund	636
National Savings Bank	22,858
State Insurance Corporations	3,165
Total	61,256

Thirdly, loanable funds provided by the Central Bank under the MLCF and foreign funds obtained for long-term lending under the Small and Medium Industries (SMI) scheme are subjected to conditions such as lenders' margins and maximum lending rates. For instance, margin available under the MLCF of the Central Bank of Sri Lanka is 4 percentage points for manufacturing lending, while in the case of agricultural lending the margin is 7 percentage points. Similar conditions are placed on long-term finance available under the SMI loan scheme.

Fourth, in the case of commercial banks, their inherent difficulty in long-term lending due to short term nature (maturity) of their resource base (deposits) acts as a limiting factor in long-term financing of the two sectors. For instance, during the last decade commercial banks have not accepted deposits with a maturity of more than two years. Furthermore, in their total deposits (including fixed deposits of not more than two years), short term deposits i.e. demand and savings deposits amounted to 62 per cent as at the end of 1990.

3.2 Repayment Problems

The long-term finances available under the MLCF of the Central Bank are guided by directions issued by the Central Bank from time to time. Also, funds are recovered by the Central Bank on due dates by debiting the accounts of participating institutions, except on rescheduled loans. The reschedulement is done on a case-by-case basis. Data on repayment problems associated with long-term finance by commercial banks based on their funds are not readily available. However, as observed by the World Bank (1989) commercial banks, especially the two state banks largely responsible for long-term lending are affected by repayment problems.

Conversely, the two long-term lending institutions, namely the DFCC and the NDB have not faced any serious repayment problems in the past. The bad and doubtful debts of the DFCC have been less than one per cent of its total assets during the period 1987-1990, while the relevant figure for the NDB has been around 2-3 per cent during the same period. It is also worth noting that the recovery rate of loans backed by the foreign (currency) loans of the DFCC is reported to be 91 per cent against a minimum of 80 per cent insisted by the World Bank on its credit lines. The World Bank in its report (1989) has noted that both the DFCC and the NDB are well managed compared to similar long-term lending institutions in developing countries.

3.3 Future Needs of Long Term Financing for Manufacturing and Agricultural Sectors

According to the forecast of Government Public Investment 1990-1994, the Sri Lankan economy is expected to grow by 5.3 per cent per annum (GDP) in real terms on an annual average basis during the period 1990-1994. When disaggregated, non-plantation agriculture is expected to grow by 3.5 per cent, while plantation agriculture will expand by 1.7 per cent. Meanwhile, manufacturing activities which are included under mining, industries and construction sector is expected to grow at a higher rate of 8.6 per cent during the period 1990-1994.

In the above context, it is important to identify the long-term credit needs of the two sectors. However, in view of the inadequate data for a considerable time period it is difficult to determine precisely the future demand for long-term finance of the two sectors. Hence, we have attempted to identify the demand for such funds by estimating the supply of long-term funds by the DFCC, NDB and commercial banks based on the past experience and forecasted gross domestic production published in the Government's Public Investment (1990-1994) document (p.23).

The estimated demand of long-term credit needs, can be viewed from an acceptable amount of supply of such credit by the DFCC, NDB and commercial banks. As shown in Table 11.13, during the period 1991 to 1994 approval of long-term credit by these institutions is expected to increase from Rs. 4,111 million to Rs. 7,395 million. This will raise the share of long-term credit by the institutions mentioned above from 0.99 per cent of the GDP in 1990 to 1.4 per cent of the forecasted GDP in 1994.

3.4 Recommendations for Further Improvements

In this sub-section, the recommendations for further improvement of long-term credit are mainly based on the factors limiting such credit, repayment problems and future demand. As noted earlier, the substantial pre-exemption of long-term funds by the government has caused problems in resource mobilisation for long-term lending. Hence, long-term savings institutions such as the Employees' Provident Fund, Employees' Trust Fund and the National Savings Bank should be freed to augment the resource base of the DFCC and NDB and invest directly in private sector debentures. Furthermore, by allowing long-term saving institution mentioned earlier to broaden their assets portfolios to invest in private company shares would also reduce the pressure on long-term finance institutions (DFCC, NDB and commercial banks) to meet the demand for such funds by the manufacturing and agricultural sectors.

Viewed from another angle, especially large and medium scale organisations engaged in manufacturing and agricultural on an individual and family or limited ownership basis, they have to be encouraged to broaden the base of their ventures by floating shares in the market, thus allowing development lending institutions to participate in their equity and to reduce the pressure on the limited funds of long-term lending institutions.

Another recommendation is to reduce the conditions placed on long-term lending institutions by providers of such funds (domestic and foreign) so that financial institutions are encouraged to use such borrowed funds and to allocate the same more efficiently among their borrowers. Also, commercial banks can raise their long-term lending further, if medium and long-term savings instruments with a maturity of 3-5 years are introduced in the market. Furthermore, especially state

Table 11.13

FUTURE NEEDS (SUPPLY) OF LONG-TERM FINANCING FOR THE MANUFACTURING AND AGRICULTURAL SECTORS

(Million Rupiah)

Year	(1) Supply of Long Term Financing 1/	(2) GDP (MP)	(3) (1) as % of (2)
1985	1108	162375	0.68
1986	1501	179474	0.84
1987	1890	196723	0.96
1988	2575	221982	1.16
1989	2738	251891	1.09
1990	3185	321057	0.99
1991	4111	373700	1.1
1992	5086	423800	1.2
1993	6163	474100	1.3
1994	7395	528200	1.4

Note: Figures for the period 1991-1994 are estimates.

1 By the DFCC, NDB and Commercial Banks as shown in Table 11.1.

commercial banks have to pay more attention on debt recovery so that the turn-over of long-term funds can be increased.

It is worth noting that in the wake of the substantial increase in investment last decade, the country has depended heavily on foreign savings or investment. For instance, during the period 1982-1990 of the total investment amounted to Rs. 335 billion, only 54 per cent has been covered through domestic savings. Hence, further attempts have to be made to raise domestic savings, especially financial savings so that enhanced funds could be channelled for manufacturing and agricultural investment. Meanwhile, in order to meet the expected expansion in future demand for long-term funds from the two sectors, long-term financial institutions may consider the introduction of variable interest rates mechanism on their borrowings and lending of long-term funds.

IV. Major Findings and Concluding Remarks

In Sri Lanka, two development banks (DFCC and NDB) and commercial banks act as major institutional sources of long-term financing for the manufacturing and agricultural sectors. Apart from the above institutions and the share market, the National Savings Bank, State Mortgage and Investment Bank, and a few leasing companies and merchant banks also provide long-term finance to both sectors in a limited way.

Of the total long-term financing by the DFCC, NDB and commercial banks, the share of agricultural sector rose to a maximum of 23 per cent by 1987 and declined to 10 per cent by 1990. On the other hand, the relevant share of manufacturing sector increased from 31 per cent in 1980 to 39 per cent in 1990, but varied substantially between 28 per cent and 72 per cent during the decade. Meanwhile, the importance of both sectors in the national economy is evident through the increase in ratio of such finance to GDP, total exports and value added in the two sectors, especially since the mid 1980s. Similarly, the contribution of the agricultural and manufacturing sectors to the GDP has been around 40-45 per cent during the period 1980-1990. Furthermore, the share of agricultural and manufacturing exports to total exports was around 90 per cent between 1980 and 1990.

When long-term financing for both sectors are analysed by product or use it became clear that the institutional credit has been concentrated towards one or two sub-sectors. For instance, the bulk of the manufacturing credit by the DFCC and NDB was extended to metals and engineering sub-sector while in the case of commercial banks financing, engineering and building trade sub-sector is significant. With respect to agricultural credit, plantation sub-sector (mainly tea) utilised the bulk of the long-term credit (agricultural) extended by all institutions under review.

During the last decade commercial banks have been the major source of long-term agricultural finance, while in the case of manufacturing, the DFCC and NDB emerged as the major sources of finance by 1990. The main sources of funds of commercial banks in turn have been deposits accepted from the public, while the DFCC and NDB depended heavily on borrowings and repayments from their borrowers for loanable funds. The Debt Recovery Act and the Credit Information

Bureau facilitated the speedy recovery of lending, while the high nominal lending rates have been highlighted as an adverse factor on credit demand.

As far back from the early 1960s, the Central Bank of Sri Lanka has been engaged in the promotion of manufacturing and agricultural sectors by providing medium and long-term refinance to participating institutions at subsidised rates. Also, it has introduced a credit guarantee scheme for small scale industries. Furthermore, credit extended for the two sectors has been excluded from credit ceiling introduced by the Central Bank from time to time. However, it is worth noting that such refinance has accounted for 36 per cent of total refinance by the Central Bank by the end of 1990, thus exerting pressure on monetary base and hence money supply.

There are several constraints limiting the access to institutional credit. The limited role played by capital markets exerts substantial pressure on institutional long-term finance, especially on development banks. This has been aggravated by the use of medium and long-term institutional finance by the government for its budgetary needs. Furthermore, commercial banks are also faced with an inherent problem of providing long-term finance based on short-term funds (deposits) in most instances mobilised at high rates. Meanwhile, an attempt has been made to quantify the future demand (1991-1994) of long-term funds from both sectors. Given the expected targets based on forecasted GDP values, the supply of long-term funds (nominal) has to be increased by 23 per cent on an annual basis during the period 1991-1994. Hence, DFCC, NDB and commercial banks have to make an enhanced effort to divert more long-term funds for both sectors, while the government should release some long-term funds currently used for its budgetary purposes to be lent to both sectors through the financial institutions. Also an emphasis placed on price stability will help to bring down high nominal deposit rates as well as lending rates which hinder the absorption capacity of long-term loans by the manufacturing and agricultural sectors.

LIST OF ACRONYMS

DFCC	–	Development Finance Corporation of Ceylon
GDP	–	Gross Domestic Product
IDA	–	International Development Association
MLCF	–	Medium and Long Term Credit Fund
NDB	–	National Development Bank
NSB	–	National Savings Bank
SMIB	–	State Mortgage and Investment Bank
SMI	–	Small and Medium Scale Industries
SSI	–	Small Scale Industries Scheme

Chapter 12

LONG-TERM FINANCING FOR MANUFACTURING AND AGRICULTURAL SECTORS IN THAILAND

by

Winai Wibhusanawit and Akrayuth Soontornwipart

12.1 MANUFACTURING SECTOR:

I. An Overview of the Existing Conditions

As in most developing countries, the capital market in Thailand is still at a relatively immature stage of development. Equity financing for business enterprises is therefore difficult to acquire. Moreover, financing through the issuance of long-term debt instruments such as bonds and debentures, is normally limited among the financial institutions. Borrowing from financial institutions has thus been a prominent feature of industrial financing in Thailand. Among the authorized financial institutions, the major institutions which provide credits to the manufacturing sector are the Bank of Thailand, commercial banks, finance companies, the Industrial Finance Corporation of Thailand (IFCT) and the Small Industries Finance Office (SIFO).

Of these, the Bank of Thailand does not extend credits directly to the manufacturers, but provides funds to commercial banks and the IFCT through the refinancing facilities. Commercial banks are the largest and the most important supplier of funds to the manufacturing sector. As shown in Table 12.1.1, in 1990, commercial banks provided credits to the manufacturing sector with the share of 85.4 per cent of the total outstanding credits extended by the above mentioned five institutions. Finance companies have also been playing a comparatively important role in industrial financing and their shares to total credits are ranked second to those of commercial banks. The IFCT and the SIFO are policy-oriented financial institutions which mainly provide medium and long-term loans to the industrial sector. In terms of credits extended to the manufacturing sector, they have ranked third and fifth, while the Bank of Thailand ranks fourth.

Table 12.1.1

CREDIT EXTENDED TO MANUFACTURING SECTOR BY MAJOR FINANCIAL INSTITUTIONS (OUTSTANDING AMOUNT)

(Million Baht)

Institutions	1986	1987	1988	1989	1990
Bank of Thailand	536.8 (0.3)	423.4 (0.2)	396.9 (0.1)	184.0 (0.1)	186.2 (0.05)
Commercial Banks	124,945 (79.5)	162,238 (83.2)	223,931 (84.1)	290,519 (84.4)	375,108 (85.4)
Finance Companies	23,371 (14.9)	24,079 (12.3)	33,626 (12.6)	43,835 (12.7)	53,688 (12.2)
IFCT	8,241.7 (5.2)	8,260.8 (4.2)	8,308.7 (3.1)	9,483.3 (2.8)	10,212.0 (2.3)
SIFO	10.5 (0.01)	23.6 (0.01)	32.3 (0.01)	44.7 (0.01)	100.3 (0.03)
Total	157,105.0 (100.0)	195,024.8 (100.0)	266,294.9 (100.0)	344,066.0 (100.0)	439,294.5 (100.0)

Source: Bank of Thailand

1.1 Sources of Long-Term Financing

Although commercial banks and finance companies have played a dominant role in extending credits to the manufacturing sector, however, most of the credits granted are short-term in nature, mainly in the forms of bills, loans and overdrafts. At the end of 1990, commercial banks provided overdrafts which accounted for 28.6 per cent of total bank lending, whereas loans and bills discounted amounted to 44.7 per cent and 26.7 per cent (Table 12.1.2). With regard to term loans, most commercial banks provided loans on the short-term basis since their major sources of funds are time and saving deposits with periods of less than 3 years. Nevertheless, overdraft financing which is convenient for borrowers for they can by-pass troublesome formalities, can be used as long-term loans by rolling them over. But generally, maturities of such credit commitments vary on a case-by-case basis and usually are within one year. As for bills discounted, business and industrial firms in need of short-term funds may sell post-dated cheques, promissory notes, or bills of exchange to commercial banks or finance companies at a discount, and with recourse. Maturities of these bills discounted are usually within one year.

Table 12.1.2

COMMERCIAL BANK'S CREDIT CLASSIFIED BY TYPES

(Billion Baht)

	1976		1986		1987		1988		1989		1990	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
1. Term loans	20.6	21.7	172.8	31.8	237.9	35.4	334.2	39.2	475.8	42.8	662.6	44.7
2. O/D	45.8	48.2	213.8	39.3	224.7	33.4	268.4	31.4	321.0	28.9	423.7	28.6
3. Bills	28.7	30.1	157.1	28.9	210.2	31.2	250.9	29.4	313.8	28.3	395.6	26.7
3.1 Domestic bills	16.1	16.9	120.7	22.2	164.1	24.4	181.6	21.3	228.3	20.7	290.9	19.6
3.2 Import bills	1.9	1.9	9.0	1.6	8.2	1.2	11.2	1.3	13.8	1.2	16.6	1.1
3.3 Trust Receipts	6.1	6.4	17.3	3.2	24.6	3.7	40.5	4.7	50.1	4.5	66.0	4.5
3.4 Export bills	4.6	4.9	10.1	1.9	13.3	1.9	17.6	2.1	21.6	1.9	22.1	1.5
Total	95.1	100.0	543.7	100.0	672.9	100.0	853.5	100.0	1,110.6	100.0	1,481.9	100.0

Source: Bank of Thailand

With regard to finance companies, since they are not allowed to take deposits like commercial banks, their principal sources of funds are promissory notes and call money which carry higher interest rates than those of bank deposits. Consequently, their term of lending is short, mainly in the form of term loans with maturities of less than one year (Table 12.1.3).

However, as for long-term loans, although commercial banks have long-term funds for long-term lendings to certain customers, their share is small. It is naturally difficult for them to finance long-term loans because of the risk of mismatching the term of the loans. As a result, long-term industrial financing has been dominated by the IFCT, the only specialized long-term financing institution for industrial development in Thailand and, somewhat to a very lesser extent, the SIFO.

Table 12.1.3

FINANCE COMPANIES' CREDIT CLASSIFIED BY MATURITY

(Million Baht)

	1976		1986		1987		1988		1989		1990 1/	
	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%	Volume	%
Call Loan	8,415.0	33.3	34,460.5	33.7	34,715.4	30.6	45,500.3	29.5	78,255.2	32.8	75,024.7	30.3
Less than 1 year	12,516.5	49.6	37,678.8	36.9	39,238.5	34.6	54,525.6	35.3	74,745.3	31.3	80,728.5	32.6
More than 1 year	4,293.5	17.1	30,107.0	29.4	39,382.0	34.8	54,382.5	35.2	85,515.1	35.9	91,809.9	37.1
Total	25,225.0	100.0	102,246.3	100.0	113,335.9	100.0	154,408.4	100.0	238,515.6	100.0	247,563.1	100.0

1 January - March 1990

Source: Financial System and Development Section, Bank of Thailand.

1.1.1 The Industrial Finance Corporation of Thailand (IFCT)

The IFCT was set up by the Industrial Finance Corporation of Thailand Act, B.E. 2502 (1959), to supersede the Industrial Bank of Thailand which had been operating since 1952. The IFCT assumed some of the assets of its predecessor in the form of an interest-free 50 year loan from the government. Despite being incorporated by a special act, the IFCT is largely owned by the private sectors, principally the Thai commercial banks, while the remaining is owned by the Ministry of Finance. At present, the Ministry of Finance owns about 16.4 per cent of the IFCT shares. The Government, through the Ministry of Finance, has the right to appoint its representative to the IFCT's Board of Directors as long as the IFCT is accommodated with government loans or government guarantee for its borrowings. In 1990, foreign and Thai commercial banks hold about 30 per cent of the total shares, followed by private sector companies holding 29 per cent, finance and securities companies holding 15 per cent, individuals and insurance companies holding 8 per cent and 1 per cent respectively. The IFCT stocks are also listed and traded on the Securities Exchange of Thailand (SET).

The IFCT's main objectives are to promote the development of industrial enterprises and the domestic capital market. More specifically, the IFCT Act (Section 11) states that the objectives of IFCT are:

1. to assist in the establishment, expansion and modernisation of industrial enterprises in the private sector; and,

2. to encourage and to bring about the participation of private capital, both internally and externally, in such private industrial enterprise, including mobilising and pooling funds and assisting in the development of the capital market.

The IFCT thus operates along the lines of a private development bank or a development finance company. It specializes in financing fixed assets through the extension of medium and long-term loans to industries, as well as working capital financing, equity participation, coordination of financial packaging activities with other local and foreign financial institutions, investment advisory services in the fields of marketing, production technique and finance, and provision of guarantees and underwriting activities. In addition, the IFCT also plays a role in managing three special funds set up by the Government namely, the Industrial Development Fund, the Capital Market Development Fund, and the Small Industry Credit Guarantee Fund.

In terms of operations, the IFCT mobilises long-term funds and allocates such funds on a long-term basis to productive investments. The Corporation uses a project financing approach and aims at providing funds to development oriented projects which are technically, financially and economically feasible. These projects should be able to grow further after the IFCT has withdrawn its financial assistance. The IFCT thus supports self-sustained growth and promotes industries in accordance with the government's national development policies.

In addition to its own registered capital amounting to Baht 4,000 million, the IFCT'S principal sources of funds at present are concessional loans from aid agencies and aid-related institutions of foreign Governments. So far, the IFCT has obtained such funds mainly from the Asian Development Bank (ADB), the Kreditanstalt fur Wiederaufbau (KfW), the Overseas Economic Cooperation fund (OECF), the Canadian International Development Agency (CIDA), the EXIM Bank of Japan, the Belgian government and the World Bank. All foreign borrowings are guaranteed by the Thai Government. Apart from these loans, the IFCT has also mobilised funds for on lending as long-term and medium-term loans through the issuance of debentures and financial papers in the domestic market. In 1990, it periodically issued debentures and other financial papers with 1 to 7-year maturities to financial institutions and the public. Additionally, convertible debentures carrying a 5-year maturity were also distributed to both local and foreign investors through the underwriters within and outside the country. The conversion of debentures into the Corporation's ordinary shares can be exercised on a quarterly basis. In order to provide liquidity to the investors, the IFCT has listed such convertible debentures for trading in the SET as well.

For the concessional sources, the IFCT has also obtained long-term credit lines from the Bank of Thailand to finance small scale industry projects, research and development projects and for developing rural projects which are located outside the Bangkok Metropolitan area. In addition, for the working capital of industrial undertakings, the IFCT has been allowed to allocate concessionary credits from the Bank of Thailand (BOT) to its clients through the refinancing scheme. In terms of acquiring short-term funds, the issuance of the IFCT Notes with open bidding from financial institutions on a weekly basis has also been undertaken (Table 12.1.4).

Table 12.1.4

THE IFCT's FUND MOBILISATION CLASSIFIED BY TYPE OF CURRENCY

(Outstanding as at 31 December 1990)

(Million Baht)

Local Currency	
– Thai Government	130.72
– Debentures	10481.65
– Concessionary loans	2109.3
Foreign Currency	
– Asian Development Bank	1396.91
– Concessionary loans	2233.77
– Exports Credits	641.64
– World Bank	384.1
– Foreign Capital Market	3836.04

Source: Industrial Finance Corporation of Thailand.

1.2 Lending Policies and Procedures

As a development finance corporation, the IFCT provides financial support to all types of manufacturing industries, tourism industry and selected services industries which contribute significantly to national economic development. Greater emphasis is also placed on the promotion of industrial development. As a result, high priority is given to the following projects:

- Export-oriented projects
- Energy-saving projects
- Projects located in regional areas
- Projects which utilize domestic raw materials
- Projects which help transfer appropriate technology from abroad
- Projects with pollution control system
- Labor intensive projects
- Supporting industries
- Basic industries

According to the present lending framework, the IFCT has outlined the terms and conditions for its financing which can be summarized as follows:

- provision of medium and long-term loans for up to 15 years with fixed or floating interest rates and certain grace period to finance investment in fixed assets such as land improvement, plant or office construction, machinery and equipment.

- minimum loan amount denominated at Baht 1 million while the maximum loan amount to any single project is 25 per cent of the IFCT's equity. (presently is Baht 1,100 million)

- tiering system for small projects with fixed assets of not more than Baht 20 million, where the loan size ranges from Baht 500,000 - Baht 10 million for the new project, and from Baht 200,000 - Baht 10 million for the expansion of existing projects.

- interest rates structure for medium and long-term loans which at present range from 15.0 - 16.0 per cent, depending on the project categories. Nevertheless, projects which have operated for a certain period of time may apply for working capital loans which are available at fixed or floating interest rates.

- exclusion of projects which the Government holds over one-third of the registered capital, or which are not registered company, are deemed not to qualify for the IFCT's financing.

- the IFCT will not finance the total cost of the project. The borrower must have some financial investment for his own proposed project. The required proportion of the borrower's own financing to the total project cost varies from industry to industry.

- in general, the IFCT accepts the following fixed assets as collateral security against loans:- factory land, buildings, machinery and equipment registered at the Ministry of Industry under the Machine Registration Act of 1971, other intangible properties or other properties and guarantees provided by commercial banks recognised by the IFCT.

- the IFCT may invest in the equity of an enterprise, but the participation normally will not exceed 25 per cent of the enterprise's total equity. This equity participation must also not be more than 10 per cent of the IFCT's capital funds.

- Guarantee credit made available to an industrial enterprise from any of the following sources:
  a) any financial institution within or outside the country; and,
  b) suppliers of machinery within or outside the country.

However, the IFCT's total financial assistance to a single enterprise, including loans, equity investment and guarantees, cannot normally exceed 25 per cent of the IFCT's equity.

With regard to the criteria used for project financing, the IFCT emphasizes potential prospects and performance of the projects rather than the creditstanding of its clients or the amount or quality of the collateral provided. Projects financed by the IFCT must therefore pass the project appraisal procedures in different aspects including the market, technical, financial, managerial, economic and environmental dimensions. On the borrower's side, if the project is systematically formulated and reaslistically assessed, a number of potential operational problems can be dealt with before the project is actually implemented. Consequently, the effective project evaluation is one of the important means of allocating scarce financial resources to the projects which will generate the most benefits to the country as a whole.

Apart from the role of providing medium and long-term loans to industrial sector, the IFCT has also been authorized to manage the Industrial Development Fund (IDF) and the Small Industry Credit Guarantee Fund (SICGF) which were set up by the government in 1980 and 1984, respectively. The objectives of the IDF are to study, analyse and monitor joint-venture projects between the Government and the private sector as well as to allocate funds for investment projects for the benefit of developing private investment. Eligible projects must be those with a potential to generate favourable economic and financial returns and be regarded by the IFCT as qualified to be granted investment funds or lending facilities. So far, the Industrial Development Fund has participated in equity investment with two industrial projects, namely, the Phoenix Pulp & Paper Co., Ltd. and Padaeng Industry Co., Ltd. The total amount of funds invested in these two projects is Baht 195 million.

With regard to the SICGF, the Fund's objective is to provide loan guarantees for small-scale industries with good prospects, but with inadequate collaterals to apply for credit from commercial banks and the IFCT. The SICGF received a start-up fund of Baht 200 million which was provided by the Ministry of Finance, by all the Thai commercial banks and the IFCT which was appointed to manage the Fund throughout the 5-year initial stage of the SICGF.

Upon completion of its 5-year operation in 1990, the SICGF received approval from the Cabinet to extend its operational period for another 5 years to 1995 during which steps would be taken to promote it as an independent organisation. Presently, the Ministry of Finance is pondering over the appropriate future status of the SIGF. Moreover, in order to respond to the expansion of its guarantee service during the extended operational period, the SICGF had also received approval to increase the maximum gearing ratio from 1 to 2 times that of the initial fund amount plus accumulated operating profit. At the same time, its regulations and procedures on guarantee service were revised to make them compatible with the investment condition, and to provide wider opportunities for entrepreneurs to make use of its service.

1.3 Performance and Impact of Long-Term Financing

Since the beginning of its operation in 1960 until the end of 1990, the IFCT has approved long-term loans for 1,789 projects, amounting to Baht 29,302.9 million. Among these projects were three types of industries that received more than 10 per cent of the total loans. Non-metallic mineral products took the largest share with the total amount of Baht 5,238.1 million or 17.9 per cent of the total share. The second largest category was agro-industries, agri-business and food processing with the amount of Baht 4,894.4 million or 16.7 per cent. The third one was iron and steel products and other metal products with the total amount of Baht 3,577.8 million, accounted for 12.2 per cent. Services also received a large share with Baht 2,626.9 million or 9.0 per cent. Other industries that received more than 5 per cent were chemicals and chemical products (7.6 per cent); textiles, wearing apparels and leather industries (7.5 per cent); and machinery (5.0 per cent) (Table 12.1.5).

Nevertheless, the cumulative data might mislead the overall picture. In 1990, the industry which enjoyed the highest amount of long-term loans was the service sector, mostly hotel business, which received Baht 869.0 million or 24.6 per cent of the total approval in that year. Non-metallic mineral products came second with an approval of Baht 589.6 million or 16.7 per cent of the total amount of long-term loans. Other major industries approved included agro-industries, agri-business and food processing (14.6 per cent) followed by textiles industries (9.8 per cent).

In terms of the geographical distribution of the IFCT funds, 162 projects or 83.5 per cent of the total number of projects approved for the IFCT's long-term loans in 1990 were located in the provincial areas, amounting to Baht 2,677.4 million or 75.8 per cent of the total loan value. This is very much in line with the IFCT's rural development policy through promotion of investments in provincial areas (Table 12.1.6).

To promote the export-oriented industry which has played a leading role in reducing the country's trade and current account deficits, the IFCT provided long-term loans amounting to Baht 1,095.8 million for 52 export-oriented projects. Starting from October 1985, the IFCT has extended special long-term credit facility for export industry projects at lower-than-normal interest rate and thus far has approved a total

Table 12.1.5

IFCT's APPROVED LONG-TERM LOANS CLASSIFIED BY TYPE OF INDUSTRY

(Million Baht)

	1990		1960-1990		
	No. of Project	Amount	No. of Project	Amount	%
1. Agro-industries, Agri-business and Food Processing	58	514.0	536	4,894.4	16.7
2. Mining and Quarrying	11	66.6	67	297.2	1.0
3. Tobacco Curing and Redrying	-	-	17	70.2	0.2
4. Textiles, Wearing Apparel and Leather Industries	13	345.4	149	2,193.8	7.5
5. Wood-based Industries	8	55.8	97	818.6	2.8
6. Furniture and Fixture	9	81.7	56	493.5	1.7
7. Pulp, Paper and Paper Products	4	70.5	35	1,174.2	4.0
8. Printing and Packaging materials	2	13.6	17	202.3	0.7
9. Rubber and Rubber Products	5	23.9	52	520.9	1.8
10. Chemicals and Chemical Products	14	171.6	130	2,240.3	7.6
11. Products of Petroleum and Coal	-	-	5	20.8	0.1
12. Non-metallic Mineral Products	18	589.6	144	5,238.1	17.9
13. Iron and Steel Products and Other Metal Products	8	101.1	111	3,577.8	12.2
14. Machinery	14	251.3	70	1,468.6	5.0
15. Electrical Machinery and Appliances	9	171.0	65	881.5	3.0
16. Transport Equipment	4	14.5	40	339.7	1.2
17. Construction	-	-	6	169.2	0.6
18. Industrial Gas	3	8.5	10	447.0	1.5
19. Transport and Storage Facilities	1	105.0	42	945.8	3.2
20. Services	6	869.0	87	2,626.9	9.0
21. Other Industries	7	78.0	53	682.1	2.3
Total	194	3,531.1	1,789	29,302.9	100.0

Source: Industrial Finance Corporation of Thailand.

Table 12.1.6

IFCT's APPROVED LONG-TERM LOANS CLASSIFIED BY SIZE AND REGION

(Million Baht)

	1990			1960-1990		
	No. of Project	**Amount**	**%**	**No. of Project**	**Amount**	**%**
Size						
Bt. 0 - 5 million	103	297.0	8.4	949	2,556.8	8.7
Bt. 5.1 - 10 million	33	277.6	7.9	308	2417.6	8.3
Bt. 10.1 - 20 million	27	442.5	12.5	283	4475.6	15.3
Bt. 20.1 - 50 million	20	679.0	19.2	137	4688.2	16.0
Bt. 50.1 - 100 million	4	290.0	8.2	68	4830.5	16.5
Bt. Over 100 million	7	1,545.0	43.8	44	10,334.2	35.2
Total	194	3,531.1	100.0	1,789	29,302.9	100.0
Geographical Region						
(A) Bangkok 1/	32	853.7	24.2	546	8,833.9	30.1
(B) Regions outside Bangkok	162	2,677.4	75.8	1,243	20,469.0	69.9
Divided into: Central Region	28	997.7	28.3	361	10,974.3	37.5
Eastern Region	17	342.7	9.7	142	3,730.7	12.7
Northeastern Region	41	320.7	9.1	239	1,348.4	4.6
Northern Region	41	728.9	20.6	257	2,124.7	7.3
Southern Region	35	287.4	8.1	244	2,290.9	7.8
Total	194	3,531.1	100.0	1,789	29,302.9	100.0

1 Including Nonthaburin and Samut Prakan.

Source: Industrial Finance Corporation of Thailand.

number of 238 projects under this policy, amounting to Baht 5,044.1 million. The majority of these projects were in the food processing and textiles industries located in various parts of the country. As for medium-term loans (ranging from 3 - 5 years maturity), in 1990, the IFCT approved a total of Baht 3,527.0 million for 38 projects as compared with the corresponding figure of Baht 3,552.0 million extended to 31 projects in 1989, thus, registering an increase of 0.1 per cent and 22.6 per cent respectively.

With regard to working capital financing, the IFCT recognized that long and medium-term loans for investing in fixed assets alone may not be sufficient to help some clients. Working capital financing is therefore designated to assist clients especially those unable to acquire sufficient working capital loans from commercial banks. In 1990, the IFCT approved working capital loans amounting to Baht 929.3 million for 177 clients who have already received either long or medium-term credits from the Corporation. This represented a significant increase of 103.5 per cent in terms of project number and 155.2 per cent in terms of loan amounts as compared to 87 projects approved for working capital loans totalling Baht 364.2 million in 1989.

With respect to equity investment, since 1969, the IFCT has been investing in the equities of various industrial projects having potential to benefit the economic and social development of the country with a view to assist in the establishment of these enterprises. As at the end of 1990, the IFCT has taken 101 equity investments in 66 industrial projects totalling Baht 1,288.7 million. In 1990 alone, the equity investments were made in 23 projects amounting to Baht 512.4 million.

Industrial projects receiving long-term loans from the IFCT in 1990 are expected to result in a total investment of about Baht 11,214 million. When these projects are operating at full capacity, about Baht 7,066 million worth of domestic raw materials will be utilized annually, while annual sales value will amount to Baht 14,918 million of which approximately Baht 7,802 million has been projected as annual export sales. In addition, these projects will create direct employment opportunities for about 14,621 persons and generate income tax revenue for the Government amounting to Baht 278 million per year. For the medium and large projects receiving long-term loans of over Baht 5 million each, it is estimated that, at full production capacity, they will generate an increase in value added of approximately Baht 3,083 million and result in a net positive effect on the country's balance of payments of about Baht. 6,065 million (Table 12.1.8).

The majority of the projects receiving long-term loans from the IFCT in 1990, that is, 84 per cent of the total number of approved projects or 76 per cent of the total long-term loan value, are located outside Bangkok, Nonthaburing and Samut Prakarn. This will result in total investments worth approximately Baht 8,886 million in the provincial areas of the country. At full production capacity, these projects are expected to generate value added of about Baht 2,342 million per year and create direct job opportunities for 10,722 persons. In addition, these projects should also increase indirect employment opportunities for the

Table 12.1.7

IFCT's OUTSTANDING LONG-TERM LOANS CLASSIFIED BY TYPE OF INDUSTRY

(As at 31 December)

(Million Baht)

	1990		1989		%
	No. of Project	Amount	No. of Project	Amount	Change
1. Agro-industries, Agri-business, and Food Processing	231	1,963.90	217	1,729.2	13.6
2. Mining and Quarrying	28	81.10	26	83.6	(3.0)
3. Tobacco Curing and Redrying	1	5.30	1	5.3	-
4. Textiles, Wearing Apparel and Leather Industries	37	369.90	38	285.2	29.7
5. Wood-based Industries	45	349.70	47	386.6	(9.5)
6. Furniture and Fixture	26	282.50	24	295.1	(4.3)
7. Pulp, Paper and Paper Products	17	488.70	15	539.7	(9.4)
8. Printing and Packaging materials	8	80.80	6	90.3	(10.5)
9. Rubber and Rubber Products	25	297.00	19	274.5	8.2
10. Chemicals and Chemical Products	53	972.30	53	885.0	9.9
11. Products of Petroleum and Coal	-	-	-	-	-
12. Non-metallic Mineral Products	54	1,270.50	42	1,376.8	(7.7)
13. Iron and Steel Products and Other Metal Products	45	1,285.10	42	1,235.6	4.0
14. Machinery	31	333.60	24	352.7	(5.4)
15. Electrical Machinery and Appliances	20	310.90	16	252.6	23.1
16. Transport Equipment	14	59.10	11	71.2	(17.0)
17. Construction	1	31.40	1	61.5	(48.9)
18. Industrial Gas	7	432.70	5	423.2	2.2
19. Transport and Storage Facilities	9	101.70	11	147.0	(30.8)
20. Services	33	1,246.10	32	791.4	57.5
21. Other Industries	27	249.70	25	196.8	26.9
Total	712	10,212.00	655	9,483.3	7.7

Source: Industrial Finance Corporation of Thailand.

Table 12.1.8

DEVELOPMENTAL IMPACT OF PROJECTS RECEIVING LONG-TERM LOANS FROM IFCT

(Million Baht)

Economic Indicators	1974-1986	1987	1988	1989	1990	Total
Total Project Cost	69,949	6,051	6,606	20,041	11,214	113,861
Value Added 1/ 2/	25,067	1,740	1,759	3,146	3,083	34,795
Values of Sales	125,242	7,643	11,211	15,535	14,918	174,549
A. Domestic	90,594	3,739	8,767	10,612	7,116	120,828
B. Exports	34,648	3,904	2,444	4,923	7,802	53,721
Direct Employment 2/ (Persons)	103,241	12,118	8,416	18,873	14,621	157,269
Utilisation of Domestic Raw Materials 2/	36,668	3,304	3,248	5,791	7,066	56,077
Contribution to Government Revenue (income tax) 2/	2,467	145	244	348	278	3,482
Net Balance of Payments Effect 1/ 2/	44,447	2,772	1,618	6,172	6,065	61,074

1 Excluding small-scale projects with loans below 5 million baht.
2 These figures were obtained from estimations of the first year of full capacity production

Source: Industrial Finance Corporation of Thailand.

upcountry population because they rely mainly on agricultural products from local farmers (Table 12.1.9).

II. The Role of Central Bank in Long-Term Financing for Manufacturing

2.1 Financing Facilities from the Bank of Thailand

In order to support industrial development in Thailand, since 1974, the Bank of Thailand (BOT) has provided long-term loans with low interest rate for the establishment and the expansion of certain industrial enterprises through the IFCT. For the first long-term credit programme

Table 12.1.9

DEVELOPMENTAL IMPACT OF PROJECTS LOCATED IN UPCOUNTRY AREAS

(Million Baht)

Economic Indicators	1974-1986	1987	1988	1989	1990	Total
Total Project Cost	52,831	5,510	3,048	18,644	8,886	88,919
Value Added 1/ 2/	17,461	1,585	984	2,686	2,342	25,058
Utilisation of Domestic Raw Materials 2/	20,636	2,974	2,435	5,110	6,130	37,285
Direct Employment 2/ (persons)	68,908	10,918	6,719	16,460	10,722	113,727

1 Excluding small-scale projects with loans below 5 million Baht.
2 These figures were obtained from estimations of the first year of full capacity production.

Source: Industrial Finance Corporation of Thailand.

with a 10-year maturity, the Bank of Thailand purchased promissory notes issued by the IFCT and guaranteed by the Ministry of Finance under the total credit line of Baht. 200 million. Eligible industries according to the programme were those export-oriented industries, import-substitution industries, industries utilizing domestic agricultural raw materials of at least 20 per cent of the total raw materials required, and industries with domestic value added of not less than 50 per cent of the total cost.

In January 1978, the Bank of Thailand granted another long-term credit line amounting to Baht 200 million to the IFCT with some revisions of criteria and conditions for financing to cope with the 5th National Economic and Social Development Plan. Therefore, apart from those export-oriented, import-substitution and high value added industries, the list of eligible industries had also been extended to cover industries with plants located in the rural area, and those with the production process directed toward energy conservation. The salient features of the first and second long-term credit refinancing programme can be summarized as follows:

1st programme	2nd programme
Inauguration: 29th March 1974	13th January 1978
Eligible industries: (1) export-oriented industries; (2) import-substituted industries; (3) industries utilizing domestic agricultural raw materials at least 20 per cent of the total raw materials used; (4) industries having domestic value added i.e., raw materials, wages and salary and other necessary domestic expenses, worth not less than 50 per cent of total costs;	(1) industries with plants situated outside Bangkok Metropolis and its outlying provinces, namely, Nonthaburi, Pathum Thani, Samut Prakarn, Samut Sakhorn and Nakorn Pathom; excepting those located in the Industrial Estate; (2) industries with the production process directed toward energy conservation; (3) export-oriented industries with the total value of exports not less than 50 per cent of the total production; (4) industries which utilize domestic agricultural raw materials not less than 50 per cent of the total raw materials used, or import-substituted industries; (5) industries with domestic value added not below 80 per cent of total production costs;
Total Credit Line: Baht 200 million :	Baht 200 million
The Amount of Loans: the maximum amount : of loans granted to the IFCT is 70 per cent of the amount of credits it has extended to each industry.	ranging between 40 per cent - 80 of per cent of the loans extended by the IFCT depending mainly upon the industry's labour employment and domestic raw materials consumption.
Maturities: maximum 10 years :	maximum 10 years
Interest Rates: 8 per cent per annum : charged by the BOT and 10.5 per cent charged by the IFCT on its customers. products;	7 per cent per annum for the industries exporting at least 50 per cent of their total
:	8 per cent for the industries producing domestically consumed goods;

1st programme		2nd programme
	:	the relending rate charged by the IFCT shall not be over 3 per cent above the BOT's interest rates.
Utilization of Loans: the full amount of Baht 200 million credit line was used by 32 industrial enterprises since 1983.	:	the full amount of credit line was used by 46 industrial enterprises since 1983.

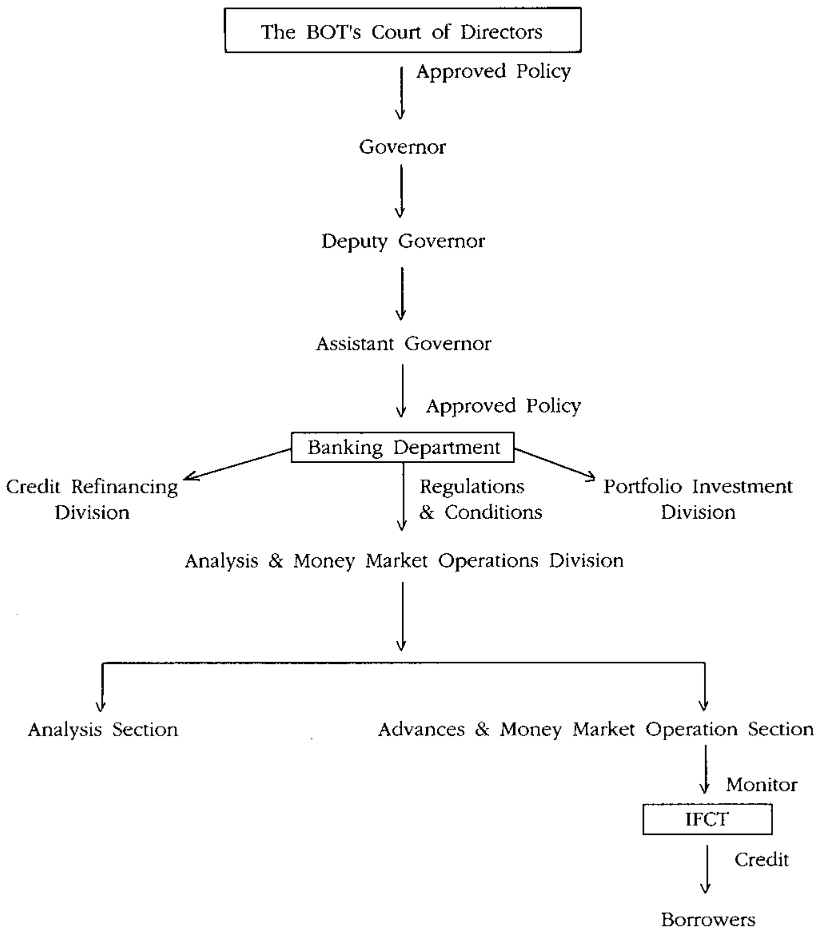
Additionally, in October 1986, the Bank of Thailand agreed to extend the IFCT for the third long-term credit line during 1987-1989 the amount of Baht 100 million for each year. The main objectives of the programme were aimed at providing long-term loans to the small-scale industry projects and for financing the research and development (R & D) activities of manufacturing enterprises. Nevertheless, the Bank of Thailand had reimposed some terms and conditions for eligible industries to ensure that its financial assistance effectively reached the appropriate industries, while extending the term of the programme to the end of 1991.

2.2 Bank of Thailand's Organization Chart for Long-term Financing

Regarding the provision of the BOT's long-term credit lines through the IFCT, the Banking Department is responsible for the regulations and conditions in accordance with the BOT's policy approved by the Court of Directors. Under the Banking Department, the Advances and Money Market Operations Division is charged with the responsibility for monitoring the IFCT to provide loans in line with the regulations and conditions set forth. The organization chart for long-term financing is summarized for reference:

2.3 Regulations

According to the third credit line, the maximum amount of loans granted to eligible small-scale industry projects through the purchasing of the IFCT's promissory notes is 70 per cent of the amount of credits extended by the IFCT to each project. The purchased promissory notes must be a 5-year maturity for the expanding projects, and a 7-year maturity for new establishments. The minimum interest rate charged by the BOT is 7 per cent per annum, while the relending rate which the



IFCT charged its clients must be lower than its maximum loan rate by 2 per cent. The eligible small-scale industry projects must have fixed assets of not more than Baht 20 million, and their loan requirements from the IFCT must not be over Baht 10 million. More specifically, they have to be at least categorized among the 56 eligible small scale industries imposed by the Bank of Thailand. In addition, for those firms which are located in Bangkok and the five nearby provinces, they must also be located in the industrial estate zones or must be labor-intensive firms (having the capital-labor ratio not more than 200,000 Baht/labor). However, with regard to loans provided for Research & Development activities, since the maturity of the purchased promissory notes is only 5-year, therefore it cannot be counted as long-term financing and will be mentioned briefly in this report.

In practice, the Bank of Thailand's regulations have also caused some problems to the performance of the IFCT, particularly in the selection of the qualified projects. The burdensome conditions on specific categories of small-scale industry and specific location of the eligible firms have resulted in too much time spent on project identification, and difficulty experienced in searching for eligible projects. Moreover, the borrowers and the IFCT have to do more paper-work to support their loan proposals in accordance with the BOT's regulations. As a consequence, the period of the third long-term credit line has been extended to the end of 1991 in order to fully utilize the total committed credit line.

2.4 Supervision Problems

At the operational level, the Bank of Thailand supervises and controls the BOT's long-term credit line extended by the IFCT through pre-determined regulations and conditions. Rather than undertaking direct involvement in analysing project proposals submitted by the borrowers, the Advances and Money Market Operations Section re-examines the qualifications of the projects which have already been approved and proposed for credits by the IFCT. In practice, the IFCT is at liberty to select and screen its customers to be eligible for the BOT's regulation and conditions. On the other hand, the Bank of Thailand can easily supervise and control its credit facility by inspecting the required documents of eligible projects submitted by the IFCT such as the detailed reports of project appraisal, Profit and Loss Account, Balance Sheet, financial and income tax statement etc. If it is found that the proposed projects do not meet the BOT's regulations and conditions, the Advances and Money Market Operations Section will reject those loan proposals and, consequently, the BOT will not purchase the proposed IFCT's promissory notes. In these cases, however, the rejected projects can still secure direct loans from the IFCT if they passed the IFCT's criteria for loan approval.

2.5 Implications for the Central Bank

With respect to the Bank of Thailand's role and procedure in long-term financing to the manufacturing sector, it is apparent that the BOT is not directly involve in the provision of such funds. The extension of long-term credits is still the main duty of, and is screened directly by, a specialized financial institution, the IFCT. The participation of the BOT in the provision of long-term credits is aimed at providing financial support to those activities which are considered to be significant for economic and social development and are genuinely in need of funding. The involvement is not to avoid or reduce the high risk of default of the projects. It is considered that this risk can be minimized by strengthening the IFCT's capability in project appraisal and, in addition, through the utilization of the SICGF's services. However, the involvement of the BOT in this type of financing also creates more complex bureaucratic requirements which cause longer processing procedures for credits approval.

III. Issues and Suggestions in Long-Term Financing for Manufacturing Sector

3.1 Factors Limiting Access to Institutional Credit

Under the present economic and institutional environment in Thailand, it is evident that long-term credits to manufacturing sector is still not being optimally distributed. Long-term credits from financial institutions, particularly commercial banks, finance companies and the IFCT are generally allocated to firms which have good relationship with the bankers or are classified as creditworthy customers, located in the urban area and having sufficient collateral. On the other hand, small and medium firms in the provincial area, which account for more than 90 per cent of the total number of industrial plants in Thailand, still lack long-term institutional credits. Some crucial factors restraining access to institutional credits can be classified from both demand and supply sides as follows:

3.1.1 On the Demand Side

It is generally accepted that supply of institutional credits cannot fully respond to all requirements. The allocation of credits to any projects depends largely on the characteristics of borrowers and their proposed projects. As for the small and medium firms in provincial area, they usually have very low capital, insufficient collateral, and low creditworthiness in terms of loan repayment, profitability and long-term viability. Furthermore, the cost of lending to these firms is usually higher than that of the large firms in the urban area. These restrictive conditions in themselves, discourage provision of institutional credits.

3.1.2 On the Supply Side

At present, there are many factors on the supply side which impede the access to long-term institutional credits. Firstly, as mentioned earlier, Thailand lacks financial institutions to provide long-term loans for the manufacturing sector. Although commercial banks and finance companies are the two major sources of credits for the Thai economy and the manufacturing sector, most of the credits granted are short-term in nature. With regard to the SIFO, eventhough it is a specialized organization in the Ministry of Industry established for the purpose of extending credits to small and cottage industries, it cannot work effectively and most of its credits provided are in medium-term (not more than 5-year maturity). The IFCT is thus the only institution to mainly finance long-term. Nevertheless, it still has a very limited role in terms of credit extension in which its share in 1990 was only 2.3 per cent of total credits provided by major financial institutions (Table 12.1.1) and in terms of branch network, it has only 7 branches in the provincial areas.

Secondly, the present structure of interest rate in Thailand, cannot attract long-term saving from the public. In developed countries, the interest rate structure follows the principle that, "the longer the term, the higher the interest rate." In Thailand, however, the interest rates for different periods of time deposits are almost the same, giving no preference to longer time deposits. Mobilization of domestic long-term fund through time deposits is therefore hardly plausible. Presently, the issuance of IFCT's debentures both convertible and non-convertible, seems to be the most effective financial instrument for mobilizing long-term funds domestically. The lack of financial instruments to mobilise domestic long-term funds is thus an impediment on the supply-side.

Thirdly, one of the most significant financial factors which may have affected the access of provincial industries to institutional credits is the BOT's policy on the loan interest rate ceiling. Since the Bank of Thailand has been rather concerned with the instability that could come from bank competition through pricing policies and, at the same time, to protect borrowers from lenders' exploitation, the loan interest rates ceiling have been set periodically. However, because there is the excess demand for funds at loan rates ceiling which generally have been set below the market rates, financial institutions, particularly commercial banks, tend to lend only to low risk customers with sufficient collateral and to the elite who have better access to bankers or having much bargaining power with institutions.

It is thus not surprising that the loan rates ceiling has given commercial banks a significant incentive not to lend to smaller and less well known entrepreneurs. This is likely to have had a strong negative impact on provincial industries. Firms which are unable to receive funds from commercial banks, have to turn to the unorganized money market where interest rates are much higher. At present, while the loan rates ceiling has generally been set at 19 per cent per year for commercial banks, it is well known that the unorganized market loan rate is at least 24 per cent per year.

With regard to the role of the IFCT, its significant role of small industries financing in the provincial area has been recognized, and more attention has been paid to setting up small industries offices to provide a special credit programme in 1984 and increasing the number of its regional offices to 7 in 1991. Furthermore, the loan interest rates for credits extended to these industries have also been set at the same level as those of medium and large industries in spite of having a higher risk and higher cost on lendings. In practice, although the loan interest rates for small industries charged by the IFCT are lower than the rates of commercial banks and finance companies, the amount of long-term credits provided by the IFCT is still very small relative to the total credit requirement.[1] The main obstacles confronting the IFCT in its efforts to provide long-term loans to small industries in provincial area are the following. First, the IFCT's loan approval procedures, base on the criteria of project financing, take too long and require detailed documents from the entrepreneurs. Many small industries generally lack systematic financial statements and relevant documents, therefore cannot wait for loan approval from the IFCT and turn to the unorganized money market instead. Second, although the IFCT was set up to promote industrial development, as a private organization it also needs to ensure growth in the future and expect reasonable returns to its shareholders.

---

1 In 1984, a team of JICA experts estimated that the total amount of credits required by the small industries in Thailand was about Baht 14,800 million whereas the institutional credits could supply only 23.5 per cent of the requirement.

The IFCT has to take into account its cost of lendings and credit-worthiness of its clients. Consequently, the medium and large industries which are more competitive in terms of credit accessment, tend to receive more credits from the IFCT than the small industries in the rural area. Third, with regard to the IFCT provincial branch network, it appears that the 7 regional offices cannot provide credits throughout the country since they are located in the large cities of the regions. The lending capability has therefore been limited and serves mainly for firms in the nearby urban area. Small industries located far from regional offices, even within the same region, have hardly been allocated credit.

3.1.3 Repayment Problems

With regard to the policies and procedures for the repayment of long-term financing for the manufacturing sector, it has been found that financial institutions in Thailand are relatively free to determine their own policies and procedures. Generally, loans provided by commercial banks and financial companies will be repaid on a regular basis by monthly installment with some grace periods. However, the duration for installment and grace periods will be considered on a case-by-case basis. For the IFCT, repayment of principal and interest are scheduled on a semi-annual, quarterly or monthly basis depending on the type of industry, projected performance and financial status of borrowers.

Nevertheless, most projects provide an adequate grace period which is derived from the project's projected cash flow. The repayment problems such as loan defaults or loan delinquency have rarely been found because all approved projects must have passed the procedures of project evaluation and, if the borrowers have any problems after loan disbursement, the IFCT will immediately send its team to solve the problems.

3.2 Future Needs of Long-term Financing for Manufacturing Sector

It is evident that industrialization will still be an ongoing economic development strategy for Thailand to pursue further in the future. As a consequence, the needs of long-term financing for manufacturing sector are expected to grow continuously in line with the industrialization process. More specifically, we can shortlist crucial factors which influence the behavior of demand of long-term financing in this sector, particularly, the expansion of the Thai economy, total investment in manufacturing sector, level of interest rate charged on long-term loans and total assets of the borrowers.

Nevertheless, after econometric testing to find an appropriate model for the estimation of demand for long-term financing for manufacturing sector in Thailand, it appears that the linear log-form equation with real GDP as the explanatory variable is the most suitable for the estimation. The estimated demand equation can be specified as follows:

$$\begin{array}{lllll} LLTLA & = & -3.0421 & + & 1.76388\ LTGDP \\ & & (-1.48814) & & (5.18825) \end{array}$$

R2	=	0.7215	SE	=	0.2434
DW	=	2.1045	F	=	26.917
N	=	11 (1980-1990)			

where : LLTLA = the IFCT's long-term loan approved for manufacturing sector in log form

LTGDP = Thailand's real GDP in log form

From the above equation, Thailand's real GDP is the only explanatory variable that can significantly explain any changes in the amount of long-term loans approved by the IFCT. The other independent variables are excluded from the selected equation since they have not passed the t-test and have lessened the quality of the estimated demand equation in terms of lower R^2 and higher standard error of regression. The elasticity of demand for long-term financing with respect to real GDP or real income of the Thai economy derived from the equation is 1.76. Therefore, it can be concluded that future needs of long-term financing for the manufacturing sector will depend largely on the expansion of the Thai economy which is rapidly following the industrialization trend.

In fact, the sign of increasing needs for long-term financing for the manufacturing sector have been evident over the past decade. During the 1980s, Thailand enhanced its industrial sector by encouraging the improvement in efficiency of production to be more competitive in the world market. New machineries and modern technology had been widely used in many industries both in import-substitution and export-oriented. Moreover, huge investment on basic industries as the base for the industrialization process was also initiated during this period. Consequently, the needs for long-term financing had been increasing continuously. This trend is expected to further increase considerably in the 1990s since the government is in the process of strengthening the financial infrastructure to cope with the new demand for financial services and, in addition, to respond to the progress of industrialization.

3.3 Recommendations for Further Improvements

With respect to factors impeding long-term financing for the manufacturing sector as mentioned earlier, it is evident that financial reforms should be implemented to improve the allocative efficiency of institutional credits and to enlarge the supply of long-term financing. In light of the guidelines for effective financial reforms, this paper would like to propose some recommendations to cope with the impediments as follows.

First, on the interest rate policy, the gradual interest rate deregulation and movement toward more market determined interest rates, which is now in the process of implementation by the Bank of Thailand, should proceed continuously. Meanwhile, if the loan interest rate ceiling has been abolished, and lending interest rate is determined freely by demand and supply, the accessibility of many firms, particularly small industries to institutional credits will increase. With flexible interest rates, commercial banks and finance companies will find it worthwhile to lend to a smaller and riskier businesses because they will be able to cover such costs by pricing their services higher. Under this circumstances, interest rates will play a major role in allocating institutional credits to provincial industries more effectively.

Second, in order to promote commercial banks and finance companies to play more significant roles in long-term financing, the Bank of Thailand should encourage their mobilization of domestic long-term funds from the public. In this aspect, interest rate and related financial policies should be designed to attract more longer term time deposit for these institutions. Besides, the initiation and promotion of the issuance of long-term instruments to mobilise domestic fund would help to remedy the situation of insufficient long-term funds. If this can be done, it is expected that small industries in the provincial area can easily access to long-term credits since the branch network of commercial banks are spread throughout the country. Nevertheless, the BOT's provincial credit policy which forces commercial banks to lend more to provincial areas needs an adjustment to ensure that long-term credits will be extended to provincial industries rather than in the form of short-term credits.

Third, at present, the Thai government is in the process of establishing the Small Industrial Finance Corporation of Thailand (SIFCT), an independent and specialized financial institution for small industry development instead of the present SIFO. It is therefore a good opportunity to streamline long-term credits for small industries in the provincial area by allocating a considerable amount of government budget as the initial and major source of fund of the institution. However, the lending rate charged to the borrowers should be non-concessionary and realistic enough to cover all costs of lendings. The promulgation of the SIFCT Act should allow the Corporation to mobilize funds independently, both domestic and foreign and, at the same time, be financially viable with no reliance on government budget, if necessary. Furthermore, in order to work effectively, the SIFCT should be alert and prepare adequate plans to cope with the problems and any impediments which may arise as in the case of the IFCT, particularly in terms of foreign exchange loss arising from too much reliance on foreign currency loans.

Fourth, with regard to the role of the IFCT, it is evident that the changing financial scene in Thailand in the 1990s will put pressure on the IFCT, in particular, the need for a reform of its current operation. The role of the IFCT should be redefined in line with the more demanding needs in the development of a more competitive financial system. The changing emphasis toward more term lending in the future, on the part of commercial banks, finance companies and SIFCT, implies that the IFCT will face tougher competition in the long-term loan market. The increasing interest rate fluctuation in the financial market means that the IFCT have to face more fluctuation in its short-term and long-term domestic resource mobilization and lending.

Concerning the above mentioned factors, any adjustment in the role and operation of the IFCT may take the following into consideration: First, on domestic resource mobilization, the IFCT should be allowed to operate fixed or term deposit account which may be confined to its clients, corporate firms and government organization. Second, with respect to foreign exchange services for the IFCT clients, permission should be granted to the IFCT to issue letters of credit and engage in other foreign exchange businesses which generate revenue to the IFCT. Third, in order to strengthen and expand the role of its regional offices in the provincial area, the IFCT should work in close cooperation with the regional offices of government agencies such as the Government Saving Bank, Department of Industrial Promotion, Credit Cooperatives, etc. Cooperation with these institutions should be designed so that they act as lending agencies, suppliers of necessary information about borrowers and as loan disbursement and repayment offices. Fourth, in light of credits extension to small industries in provincial area, the IFCT's loan approval procedures should be revised to make them compatible with the loan sizes, cost of lending, availability of borrowers' document and timing of loan requirement. If possible, loan approval procedures for small industries should be improved to shorten and lessen time-consumed as in the case of regular projects approval. Fifth, it is undeniable that equity financing is a more appropriate mean for industrial long-term financing. This is due to the fact that equity financing does not involve debt repayments. Moreover, equity or shareholders' fund are part of the company's assets and would therefore contribute to the long-term development of the enterprises. Nevertheless, equity financing requires a developed capital market which should be the long-term strategy of the government as it would greatly contribute to the industrial development financing of the country.

IV. Major Findings and Concluding Remarks

At present, the salient feature of industrial financing in Thailand is borrowing from financial institutions. Equity financing and financing through the issuance of long-term debt instruments are not widespread nor easily acquired. Among the five major financial institutions which provide credits to the manufacturing sector, commercial banks are the largest and the most important supplier of funds. Finance companies also play an important role but their shares to total credits are ranked second to those of commercial banks. Nevertheless, with regard to term loans, most credits provided by these two institutions are on short-term basis since their major sources of funds are financial assets with maturities less than 3 years.

Turning now to the other three financial institutions namely the Bank of Thailand (BOT), the IFCT and the SIFO, the BOT does not extend credits directly to the manufacturers, but provides funds to commercial banks and the IFCT through the refinancing facilities. The IFCT and the SIFO are policy-oriented financial institutions which mainly provide long and medium-term loans to the industrial sector. However, their shares of extended credits are ranked third and fifth, while the Bank of Thailand ranks fourth. Among these institutions, it appears that the IFCT which was set up in 1959 by a special Act is the most significant institutional source of long-term industrial financing. The IFCT'S main objectives are to promote the development of industrial enterprises and the domestic capital market. It is largely owned by the private sectors, principally the Thai commercial banks, while the Ministry of Finance owns about 16.4 per cent of the total shares. In addition to its own registered capital amounting to Baht 4,000 million, the IFCT's principal sources of funds at present are concessional loans from aid agencies and aid-related institutions of foreign Governments. All foreign borrowings are guaranteed by the Thai Government. Apart from these loans, the IFCT has also mobilised funds for on-lending as long-term and medium-term loans through the issuance of debentures, both convertible and non-convertible, and financial papers in the domestic market. Besides, the IFCT has also obtained long-term credit lines from the Bank of Thailand to finance small industry projects, research and development projects and for developing rural projects located in provincial areas. Furthermore, for the working capital financing, the IFCT has been allowed to allocate concessionary credits, through the BOT refinancing scheme.

With regard to lending policies, the IFCT provides credits to manufacturing industries, tourism industry and selected services industries which contribute significantly to national economic development such as export-oriented projects, energy-saving projects, basic industries etc. As for the criteria used for project financing, the IFCT emphasizes potential prospects and performance of the projects, rather than the creditstanding of its clients or the amount or quality of the collateral provided. Projects financed by the IFCT must pass the project appraisal procedures including the market, technical, financial, managerial, economic and environmental dimensions. As a consequence, the repayment problems of approved projects such as loan defaults or loan deliquency rarely occurred.

With regard to the financing facilities from the Bank of Thailand, the BOT has also provided low interest long-term loans through the

IFCT for the establishment and the expansion of certain industrial enterprises. In 1974 and 1978, the BOT launched the first and second long-term credit programme, amounting to Baht 200 million each with a 10-year maturity, through the purchasing of the IFCT's promissory notes. The minimum interest rate charged by the BOT is 7 per cent per annum, while the relending rate which the IFCT charged its clients must not exceed 3 per cent of the BOT's interest rates. Eligible industries according to the programmes were those which correspond to the National Economic and Social Development Plans such as export-oriented industries, import-substitution and high value added industries, industries located in regional areas, etc. Furthermore, in 1986, the BOT provided the third long-term credit programme amounting to Baht 300 million to the IFCT for further extension during 1987-1991. In line with this programme, eligible industries must be small industries in provincial areas, and those whose business are in the research and development activities.

According to the above financing facilities, eventhough the BOT can easily supervise and control the operations by inspecting the eligibility of the projects through reports and required documents prepared by the IFCT, the burdensome conditions and inspections on specific categories of eligible industries, in turn, create more complex bureaucratic requirements. The BOT's involvement therefore caused longer processing procedures for credits approval.

In the meantime, after taking into account the scope of institutional credit in Thailand, it is found that long-term credits are generally allocated to firms which have good relationship with the bankers, or are classified as creditworthy customers, located in the urban area and possessing sufficient collateral. Small and medium firms in provincial areas which account for more than 90 per cent of the total number of industrial plants in Thailand are still lacking in long-term institutional credits. This is due to the crucial factors limiting the access to institutional credits which exist on both the demand and supply sides. On the demand side, the main characteristics of small and medium firms in provincial area, particularly, insufficient collateral, very low capital, low credit worthiness in terms of loan repayment, profitability and long-term viability discouraged the provision of institutional credits to these firms. Meanwhile, on the supply side, many factors which impede the accessibility of those industries are:

- the lack of long-term financial institutions;
- the shortage of financial instruments to mobilise domestic long-term funds;
- the existence of loan interest rate ceiling which discourages commercial banks and finance companies from lending to high cost and high risk customers; and,
- the obstacles confronting the IFCT in the provision of long-term loans to small industries in provincial area such as the cumbersome loan approval procedures, the needs to ensure growth and self-reliance of the IFCT, the IFCT's lack of branch network in provincial area; etc.

In light of the future needs of long-term industrial financing, it is expected that the needs will grow continuously in line with Thailand's industrialization process. The estimated value of 1.76 of the elasticity of demand for long-term financing with respect to the real income of the Thai economy implies that the future needs will depend largely on the expansion of the Thai economy which is rapidly following the industrialization path. Furthermore, the on-going process of strengthening the financial infrastructure to cope with the new demand for financial services will be another factor to ensure this expectation.

With respect to the recommendation for further improvement of long-term industrial financing, this paper proposes some guidelines to cope with the impediments as follows. Firstly, the Bank of Thailand should proceed on the policy of interest rate deregulation continuously until the lending interest rate of institutional credits is determined freely by demand and supply of the market. The flexible lending rates will encourage commercial banks and finance companies to lend more to smaller and risker businesses since they will be able to charge higher rates to cover the costs. Secondly, the interest rate and related financial policies should be designed to facilitate commercial banks and finance companies in the mobilization of domestic long-term funds from the public. However, at the same time, the present BOT's provincial credit policy should be redesigned to ensure that long-term credits be extended to provincial industries rather than in the form of short-term credits.

Thirdly, the establishment of the Small Industrial Finance Corporation of Thailand (SIFCT) will greatly help streamline long-term credits for small industries in provincial area. In order to strengthen and boost the institution to operate most effectively, the government should put up an initial budget as the major source of fund of the Corporation. In addition, it should be well planned to be financially viable and be able to cope with the problems which may arise as in the case of the IFCT, particularly in terms of foreign exchange loss. Fourthly, the role of the IFCT should be redefined in line with the more demanding needs in the development of an increasingly competitive financial system. The Corporation should be allowed to operate fixed or term deposit account to rely more on domestic resource mobilization. Issuance of letters of credits and engagement in other foreign exchange businesses should be permitted to generate more revenue to the institution. Close cooperation with the regional offices of various government agencies should be promoted to enlarge its role in providing credits to provincial areas. Moreover, the loan approval procedures should be revised to make them compatible with the financing of small industries in provincial area.

Lastly, in the long run, the government should proceed on the development of the capital market as the basis for equity financing. It is undeniable that equity financing is a more appropriate mean for industrial long-term financing since this kind of fund is part of the company's assets and would therefore contribute to the long-term development of the enterprises.

Table 12.1.10

IFCT's APPROVED LONG-TERM LOAN APPROVALS, COMMITMENTS, DISBURSEMENTS AND OUTSTANDINGS

(Million Baht)

Year	Approvals		Commitments		Disbursements	Outstandings 1/	
	No. of Project	Amount	No. of Project	Amount		No. of Project	Amount
1960-1985	999	16,230.5	913	14,719.4	12,582.5	426	8,119.2
1986	141	1,449.7	131	1,383.3	1,135.5	506	8,241.7
1987	139	2,264.4	132	1,419.1	1,143.7	580	8,260.8
1988	134	2,276.7	116	2,314.0	1,435.0	597	8,308.7
1989	182	3,550.5	185	2,352.1	2,671.7	655	9,483.3
1990	194	3,531.1	181	3,609.6	2,783.0	712	10,212.0
Total	1,789	29,302.9	1,658	25,797.5	21,751.4		

1 As at 31 December

Source: Industrial Finance Corporation of Thailand.

Bibliography

Bank of Thailand, *Financial Institutions in Thailand,* Various Issues, (mimeograph).

Industrial Financial Corporation of Thailand, *Annual Report,* Various issues.

Industrial Finance Corporation of Thailand, IFCT's *Twentieth Anniversary Issue,* 1979.

Industrial Management Co. Ltd., *Financial Strategies for Industrial Restructuring,* (Industrial Restructuring Study for the National Economic and Social Development Board, Final Report Vol.II), Bangkok, 1985.

Long-term Credit Bank of Japan, Ltd., *Proposals for Introducing Long-Term Industrial Financing in Thailand,* March 1986.

Loha-unchit, Chesada, *Policies, Instruments and Institutions for Rural Industrial Development,* Thailand Development Research Institute, 1990.

Soontornwipart, Akrayuth, "Financial Strategies for the Promotion of Small Industries in the Rural Area", Bank of Thailand, *Monthly Bulletin,* November 1988 (in Thai).

12.2 AGRICULTURAL SECTOR:

I. Introduction

Agriculture is one of the most important sectors of the Thai economy. Its importance may be gauged in term of population which 35 million or 63 per cent of the total 55 million engaged in agriculture and allied occupations. Its share of the country's Gross Domestic Product totalled to about 15 per cent as compared to the share of manufacturing which stood at 25 per cent.

In the early days, most Thai farmers practiced agriculture at the whim of climatic elements. Much of the growth in agricultural output resulted from the expansion of the cultivated area rather than from the changing in farming methods. It was cleared that the country's future growth in agricultural output would slow down as expansion neared the limits of the land frontier. So efforts have been made to relief the pressure on land and to promote farmers in adopting their farming practices to modern techniques and production methods.

The government has allocated more budget in building up infrastructure facilities in rural areas e.g. roads, dams and irrigations, with a view to stimulating agricultural productivity, increasing the level of farm income, accelerating the transfer of farm technology and generating farm employment. At the same time, agricultural credit is one of the policy instruments employed for achieving these goals.

The basic agricultural credit policy was administrated with the assumption that farmers would be able to utilize more financial resources to help increase their harvest and income. In pursuance of the policy, the Bank for Agriculture and Agricultural Cooperatives (BAAC) was established in 1966 to supply farmers and other agricultural organizations with working capitals and The Bank of Thailand (BOT), the central bank, adopted in 1975 a quota system to regulate commercial bank lending to the agricultural sector. These have resulted in a rapid increase of agricultural credit from institutional sources and consequently a number of agricultural and rural investment.

II. An Overview of the Existing Conditions of Long-Term Financing for Agricultural Sector

2.1 Nature of Long-Term Financing for Agricultural Sector

2.1.1 Institutional Credit Structure

In Thailand, credit institutions involved in providing agricultural credit consists of the Bank of Thailand (BOT), the BAAC and commercial banks at the top level and the agricultural cooperatives and registered farmers groups at the grass-root level.

The BOT plays two roles. It regulates and coordinates the use of resources, especially for commercial banks, and provides resources to formal credit institutions. It provides rediscounting facilities to commercial banks and BAAC.

The BAAC and commercial banks are the main and direct sources of credit to farmers. In addition to their own farmer clients, the BAAC in particular, would also provide a large proportion of the credit requirements of agricultural co-operatives and registered farmer groups for re-lending to their members.

Agricultural co-operatives and registered farmer groups are formed and organized with the objective of providing an "integrated package" to help improve the standards of living in rural communities through the provision of credit, marketing, farm supply, processing, farm extension and other services related to farmers. Their loanable funds are from their own savings, BAAC, commercial banks and government agencies. The fund is usually provided at subsidized rate to be used as working capital, or for the marketing and construction of rice mills and warehouses.

2.1.2 Trend in Long-Term Finance

As mentioned above, the major institutions providing agricultural credit are the BAAC and commercial banks. They provide credits in accordance with government policy which emphasizes the need for farmers to have adequate fund to practice agriculture each year. They can perform their tasks in assisting agricultural development. However, they are limited by some factors which mostly are beyond the banks' control. Those will be discussed later on.

Long-term lending for agriculture from institutional sources are shown in Table 12.2.1.

Table 12.2.1

OUTSTANDING OF LONG-TERM AGRICULTURAL CREDIT, BY INSTITUTIONAL SOURCE

(Million Baht)

	1975	1980	1985	1988	1989	1990
1. BAAC 1/	115.3	1,672.7	5,037.9	6,376.0	8,285.0	10,302.8
2. Commercial Banks 2/	n.a.	n.a.	n.a.	5,622.6	8,166.7	12,079.8
3. Total Long-Term Credit	115.3	1,672.7	5,037.9	11,998.6	16,451.7	22,382.6
4. Average Annual Growth Rate (%)	<-----70.7---->	<----24.7---->		<---------------36.6------------>		
5. Total Credit (BAAC + CBs)	6,834.0	25,385.5	61,011.8	84,132.9	103,803.5	140,894.0
6. (3) as % of (5)	1.7	6.6	8.3	14.3	15.8	15.9
7. Agricultural GDP 3/	62,081.0	152,852.0	169,895.0	250,384.0	271,443.0	254,523.0e
8. (3) as % of (7)	0.2	1.1	3.0	4.8	6.1	8.8
9. Agricultural and Product Exports	34,107.6	77,403.6	115,974.1	194,198.1	230,536.7	272,033.0e
10. (3) as % of (9)	0.3	2.2	4.3	6.2	7.1	8.2

1 Outstanding amount at the end of December.
2 Data of long-term credit of CBs before 1988 are not classified and not available.
3 Amount at current price.
e = Estimated

The growth in long-term agricultural credit from institutional sources between 1975-1980 was averaged at 70.7 per cent per annum which was rather high. This was due to the government's directive for BAAC to provide loan to farmers for refinancing old debts incurred in agriculture and also for investment in agricultural assets. The farmers had appealed to the government to help them redeem previously owned land mortgaged to (or forfeited by) private money lenders. The growth rate during 1980-1985 slowed to an average of 24.7 per cent per annum as the BAAC had limited funds available for long-term lending. Nevertheless, as agriculture began to switch from extensive to intensive agriculture, the long-term agricultural credit growth rose to 36.6 per cent per annum during 1988 and 1990 with higher commercial banks' participation in long-term lending to agriculture. In 1990, the share of long-term agricultural credit accounted for 15.9 per cent of the total institutional lending, 8.8 per cent of agricultural GDP, and 8.2 per cent of total agricultural and agricultural product exports which nearly doubled the shares of 8.3 per cent, 3.0 per cent and 4.3 per cent in 1985 respectively. These trends reflected a greater contribution of long-term credit to agricultural development.

2.2 Sources of Long-Term Financing, Lending Policies and Procedures

2.2.1 Commercial Banks

Background

Prior to 1975, non-institutional sources (e.g. private money lenders, relatives, neighbours and local merchants) had played a vital role in providing credit, financing about 72 per cent of the total rural credit to farmers. Only the remaining 28 per cent was provided by institutional sources. Meanwhile, agricultural lending provided by commercial banks plus BAAC was approximately 3-4 per cent of agricultural GDP (Table 12.2.2). For commercial banks alone, direct lending for agricultural purposes in 1974 amounted to 241.8 million baht which could meet only 1.5 per cent of the total credit requirements of which was estimated at 16,000 million baht.

In recognition of the fact that institutional lending to the agricultural sector was negligible, the government decided to request all commercial banks, through the Bank of Thailand, to play a more significant role in lending to farmers. As a consequence, commercial banks were then asked to meet various mandatory agricultural lending targets, the major ones of which are still in effect. (see details in Part III).

Lending Operation

Agricultural lending comprised:

(i) Individual farm credit given to individual farmers;

(ii) Joint liability credit advanced to a group of farmers; and,

(iii) Deposits with the BAAC.

Table 12.2.2

LENDING TO FARMERS AS A PERCENTAGE OF AGRICULTURE GDP 1970-1974

(Million Baht)

Year	Total GDP (Market Price)	Agriculture GDP	Agriculture Credit (Commercial Banks + BAAC)	Agr. GDP to Total GDP (%)	Agr. Credit to Agr. GDP (%)
1970	136060	38493	1309	28.29	3.4
1971	144607	40786	1514	28.2	3.71
1972	146626	49919	1824	34.05	3.65
1973	216543	72233	2057	33.82	2.81
1974	271368	84735	3384	31.23	3.99

Individual farm credit is normally advanced to big farmers who are well established but need to strengthen their capital base for improved production. Group lending is made without collateral in respect of small farmers scattered around the bank branch. In recent years, Bangkok Bank has become one of the few banks lending to farmer co-operatives. Deposits of commercial banks with BAAC will be made whenever their direct lending fall short of government's targets.

Crop production i.e. rice, cassava, sugarcane and maize is the main outlet of lending. However, the lending share of crop production in the total commercial banks' agricultural lending during 1975 to 1990 has been decreasing from 77.3 per cent to 60.3 per cent. On the contrary, the lending share of livestock and fisheries has been substantially increased during the period (Table 12.2.3). These trends reflected a greater participation of livestock and fisheries in generating agricultural outputs and in the commercialization process of farmers' farming. The fisheries and livestock raising activities require more advance technology and a larger amount of medium and long-term loans than crop producing.

It is worth to note that commercial banks lending has been mostly of short-term maturities. Eventhough commercial banks have been making some progress in lengthening term structure, most loans are still short-term (Table 12.2.4).

Security

Agricultural loans are advanced against securities in the case of individual farms. In the case of group lending no such securities are insisted upon but the hypothecation of future crop is undertaken. Some commercial banks exercise the necessary supervision in the case of both types of loans through the head office as well as by the provincial branch offices.

Rate of Interest

Commercial banks can charge on their agricultural loans up to the overall ceiling (presently 19 per cent per annum). In practice, commercial banks lend to farmers at the rate of between 16 per cent - 19 per cent per annum (differentiating the rates by the size of customer or loan rather than by the sector).

Fund Mobilization

In the execution of its business, commercial banks derives fund from the following sources:

- Mobilization of public deposits in the form of demand deposits, saving deposits and time deposits.
- Fund from the Central Bank to finance programme loans.
- Loan from other financial institutions.

2.2.2 The BAAC

Background

The BAAC is considered to be the leader among credit institutions in providing credit to farmers. It was established under the Bank for Agriculture and Agricultural Co-operatives Act in 1966 as a government-

Table 12.2.3

OUTSTANDING OF COMMERCIAL BANKS LOANS BY PURPOSES

	Amount (million Baht)						Lending Share (%)						Average Annual Growth (%)	
	1975	1980	1985	1988	1989	1990	1975	1980	1985	1988	1989	1990	1975-85	1985-90
Crop	1,761.6	8,531.3	26,547.5	35,159.1	43,006.5	58,370.2	77.3	71.5	70.3	63.2	60.0	60.3	31.2	17.1
Fisheries	323.8	1,427.2	3,628.2	9,180.2	13,268.5	18,492.0	14.2	11.9	9.6	16.5	18.5	19.1	27.3	38.5
Livestocks	192.5	1,978.7	7,720.3	11,322.3	15,408.7	19,862.1	8.5	16.6 20.4	2	0.3	21.5	20.5	44.7	20.8
Total	2,277.9	11,937.2	37,896.0	55,661.6	71,683.7	96,724.3	100.0	100.0	100.0	100.0	100.0	100.0	32.5	20.6

Table 12.2.4

OUTSTANDING OF COMMERCIAL BANKS LOANS BY TYPE AND TERM

Type of Loans	Amount (million Baht)					Lending Share (%)					Average Annual Growth (%)
	1975	1980	1988	1989	1990	1975	1980	1988	1989	1990	1988-90
Overdraft	1,082.3	5,310.4	18,941.9	23,327.0	30,389.1	47.5	44.5	34.0	32.5	31.4	26.7
Loan:	723.2	4,669.5	29,928.6	38,765.7	53,023.6	31.7	39.1	53.8	54.1	54.8	33.1
Less than 3 years	n.a.	n.a.	16,789.1	21,114.0	27,784.6	-	-	30.2	29.5	28.8	28.6
3-5 years	n.a.	n.a.	7,516.9	9,485.0	13,159.2	-	-	13.5	13.2	13.6	32.3
Over 5 years	n.a.	n.a.	5,622.6	8,166.7	12,079.8	-	-	10.1	11.4	12.4	46.6
Bills & Others	472.4	1,957.3	6,791.1	9,591.0	13,311.5	20.7	16.4	12.2	13.4	13.8	40.0
Total	2,277.9	11,937.2	55,661.6	71,683.7	96,724.3	100.0	100.0	100.0	100.0	100.0	31.8

owned bank to provide financial assistance in order to promote the agricultural operations of individual farmers, agricultural co-operatives and farmers groups. Prior to 1 November 1966, BAAC was known as the Bank for Co-operatives and functioned as a source of loan funds for co-operatives. It was felt, however, that in the interests of developing the country's agriculture, loans should be expanded to include individual farmers and farmers groups as well as agricultural cooperatives. These multi-credit operations, nevertheless, should be controlled as previously for the strength and convenience of bank operations. Thus, in 1966, BAAC was founded in place of the Bank for Co-operatives with all fixed and current assets, liabilities, responsibilities, business operations, officers and employees being transferred to BAAC.

BAAC loaning procedures are based on regulations which specify inter alia, the type of borrowers, the purposes of the loans, repayment periods, loan ceilings and interest rates. Authorized share capital of BAAC is presently 4.0 billion baht of which the amount paid in is 2.6 billion baht. Under the BAAC Act, individual farmers, agricultural cooperatives, farmers' association, and other financial institutions are allowed to hold up to 10 per cent of the capital; in practice, the Ministry of Finance holds 100 per cent. The policies and activities of BAAC are controlled largely by the Minister of Finance through a Board of Directors consisting of eleven members appointed by the Council of Ministers. The Chairman is the Ministry of Finance, who is in charge of implementing the BAAC Act. The Vice Chairman is usually a representative of the Ministry of Agriculture and Cooperatives and the BAAC President is the Secretary of the Board. The main responsibility of the Board is to formulate the operating policies of BAAC and to control and supervise its activities.

Lending Operation

In order to achieve its stated objective, BAAC has provided loans directly to farmers who are bank clients, to farmers groups, and to agricultural co-operatives. The latter two institutions relend the loans to their farmer members. BAAC also provided loans to the latter institutions, for revolving funds to purchase agricultural inputs and other necessities for resale to members and non-member farmers, for investment funds to obtain fixed asset for processing or marketing agricultural products, or providing farm inputs, or agricultural services, and finally long-term loans for agricultural developments.

- ***Types of Loans***

BAAC mainly operates three types of loans, short term, medium term and long term. However special project loans are also given to farmers whose projects have been justified as feasible projects.

Short-term loans are provided to assist the farmer to defray his annual seasonal production expenses. The maturity period for short-term loans is fixed at 12 months but allowance of up to a further 6 months can be made for special cases.

BAAC provides three types of short-term loans as follows:

- Short-term loans for main-crop production.
- Short-term production loans for other agricultural purposes.
- Short-term loan for postponement of sale.

Medium-term loans are provided to enable farmers to invest in agricultural assets whose usefulness normally exceeds a single production season. The maturity period of this type of loan varies from 3-5 years.

Long-term loans are provided to individual client farmers in two types:

- Long-term loan for refinancing old debts commencing in 1969.
- Long-term loan for investment in agriculture commencing in 1975.

The maturity of long-term loan of the first type varies from 10-12 years while it is 15-20 years for the second type.

The BAAC's lending operations are summarized in Table 10.2.5.

Short-term loans, except in 1975, account for more than 70 per cent of BAAC's portfolio. They fall under three main categories:

(a) production loans, which now account for about 95 per cent of BAAC short-term lending (particularly for rice, 60 per cent);

(b) storage loans for assisting farmers with their cash flow in the event that they are unwilling to sell their products in a depressed market; and,

(c) cash credit lines.

Table 12.2.5

DISBURSEMENT OF BAAC LOANS, 1975-1990

(Million Baht)

	Direct Lending					On Lending Through					
	Short	Medium	Long	Sub-total		Co-operatives		Farmers Associations		Total Disbursement	
	(Amt.)	(Amt.)	(Amt.)	(Amt.)	(%)	(Amt.)	(%)	(Amt.)	(%)	(Amt.)	(%)
1975	1,298	709	94	2,101	63	866	26	388	11	3,355	100
1980	4,136	1,254	560	5,950	72	2,245	27	90	1	8,285	100
1985	10,936	1,222	1,985	14,143	82	3,181	18	26	-	17,350	100
1986	17,709	83	1,745	19,537	84	3,659	16	23	-	23,219	100
1987	15,764	4	2,085	17,853	82	3,913	18	30	-	21,796	100
1988	16,581	1,204	3,364	21,149	83	4,314	17	38	-	25,501	100
1989	22,292	1,189	4,532	28,013	83	5,795	17	25	-	33,832	100
1990	22,650	5,965	4,394	33,009	82	7,003	18	28	-	40,040	100
Average Annual Growth											
1975-80	26.1%	12.1%	42.9%	23.1%		21.0%		-25.3%		19.8%	
1980-85	21.5%	-0.5%	28.8%	18.9%		7.2%		-22.0%		15.9%	
1985-90	15.7%	37.3%	17.2%	18.5%		17.1%		1.5%		18.2%	

Individual borrowers who are unable to provide collateral are required to join the joint liability groups, to ensure favorable repayments through socio-economic pressure from its members. The minimum group size is five and the maximum is thirty. The maximum loan amount per group member is 60,000 baht. Most of BAAC'S short-term loans are unsecured relying mainly on the collective guarantee of the farmers' groups, a system which enabled it to expand its outreach without significantly jeopardizing its repayment record.

Medium-term loans are used for investment in agricultural assets which are normally usable for a period longer than one crop season, such as loans to meet expense in the reclamation of agricultural land, purchases of agricultural machinery and investment for raising livestock. The repayment of this type of loan is normally due within three years except in extraordinary cases where the repayment may be made within five years.

Long-term lending is rather at a low level about 16 per cent of direct disbursement. This was due mainly to the Bank's requirement that a borrower must provide both his land and not less than 20 per cent of the total amount of capital investment required, as collateral. But perhaps the most important reason is the farmer's own lack of initiative coupled with his inability to think beyond the bounds of minor improvement schemes. Despite these constraints, however, the BAAC's long-term lending operations have continued to expand. Land development, investment in livestock, and farm building construction are examples of items of a long-term investment nature financed by the BAAC (Table 12.2.6).

- ***Special Development Projects***

In 1977 the BAAC introduced the idea of special development projects to support long-term investment activities in areas with suitable resources where participating farmers would receive special assistance with particular farming activities. The projects are normally prepared by the BAAC in cooperation with relevant government and private sector agencies who undertake to provide technical and marketing services. This approach has reduced the risks of lending, therefore enabling the Bank to relax some of its normal loan security criteria and extend its services to farmers who might not otherwise be considered eligible for long-term loans.

By 1990, the BAAC had provided credit services to a total of 221 separate special projects involving 1,138,955 farmers and with total loan outstanding amounting to 5,850 million baht.

Security

In lending to small scale farmers, who do not have adequate collateral in the form of mortgage assets, the use of joint liability is introduced as the security for short-term loans. Under this criteria each farmer member can acquire loan amount of 30,000 baht. Where the loan is more than 30,000 baht as well as term loans for agricultural investment require a 20 per cent equity contribution, two guarantors, or the mortgage of fixed assets worth twice the value of loan. If, however, the farmer is in a position to pledge government bonds no security of land is required and loan is given up to 80 per cent of the value of the government bonds. In the case of processing unit for agricultural produce, hypothecation of assets is permitted.

Rate of Interest

According to the charter incorporated in the BAAC Act of 1966, BAAC can charge interest rates only up to the levels approved by the Board of Directors. In effect this means that changes of interest rates must be approved at the cabinet level. The policy has been to maintain interest rates at a level of 2 or 3 percentage points below that charged by the commercial banks.

The interest rate structure of BAAC is as indicated:

- ***Interest Rate Structure on Loans to Client Farmers***

Type of Loan	*Interest Rates*	*Maximum Loanable Amount*
Short term loan – for main-crop production – for other agricultural purposes	1. 12.5 per cent Simple interest 2. 9 per cent Simple interest for loans from the Special Agricultural Promotion Fund	5,000,000 baht (for short + medium term loans)
Medium term loan		

Short term loan for postponement of sale	12.5 per cent Simple interest	100,000 baht
Long term loan for refinancing old debts	12.5 per cent Simple interest	300,000 baht
Long term loan for investment in agriculture	11.5 per cent Simple interest 9 per cent Simple interest for Project Loan for Promotion of Export or Import Substitution or Farm Remodeling	500,000 baht

• *Interest Rate Structure on Loans to Farmers' Institutions*

Type of Loan	***Interest Rates***	***Maximum Loanable Amount***
Agricultural Cooperatives		
– for onlending to members interest	9.5 per cent Compound	10,000,000 baht
– for purchasing agricultural inputs	9.5 per cent Compound interest	Six times amount of own funds
– for marketing agricultural products	12.5 per cent Compound interest	5,000,000 baht
– for term loan for investment in agriculture	10.5 per cent Simple interest	5,000,000 baht
Farmers' Associations		
– for onlending to members	9.5 per cent Compound interest	1,000,000 baht
– for purchasing agricultural inputs	9.5 per cent Compound interest	Four times amount of own funds
– for marketing agricultural products	12.5 per cent Compound interest	5,000,000 baht
– for term loan for investment in agriculture	10.5 per cent Simple interest	5,000,000 baht

Fund Mobilization

The sources of funds for BAAC's operations are summarized in Table 12.2.8.

BAAC's funding comes from four main sources:

Table 12.2.6

LONG-TERM LOANS TO CLIENT FARMERS CLASSIFIED BY PURPOSE FISCAL YEARS 1980-1990

Loan Purpose	1980		1985		1990	
	Million Baht	%	Million Baht	%	Million Baht	%
A. Investment in agricultural machinery and farm buildings						
1. Purchase construct or make improvements to agricultural machinery and equipment used in land clearing and on-farm development for production of paddy, field crops, plantation crops, pasture, etc.)	98	18.0	375	18.9	484	11.0
2. Purchase or construct farm buildings	57	10.5	124	6.2	423	9.6
3. Purchase pumping engines and pump accessories	14	2.6	22	1.1	16	0.4
4. Purchase of construct farm based processing equipment	2	0.4	22	1.1	49	1.1
5. Purchase transportation vehicles and equipment	13	2.4	77	3.9	329	7.5
6. Purchase spraying equipment for pest and weed control	-	-	1	0.1	1	0.0
Sub-Total	184	33.9	621	31.3	1302	29.6
B. Investment in land for agriculture and irrigation infrastructure						
1. On-farm land development	157	28.9	393	19.8	1031	23.5
2. Purchase land for agriculture	58	10.7	365	18.4	424	9.7
3. Purchase tenancy rights to land for agriculture	1	0.2	4	0.2	7	0.2
4. Development of water sources for irrigation	21	3.8	23	1.2	140	3.2
Sub-Total	237	43.6	785	39.6	1602	36.5
. Investment in livestock						
1. Purchase draught animals	42	7.7	113	5.7	11	0.3
2. Purchase breeding stock	57	10.5	321	16.2	1107	25.2
Sub-Total	99	18.2	434	21.9	1118	25.5
D. Investment in other categories						
1. Purchase marine fishing equipment (fishing boat, boat engine, net, etc.)	3	0.6	6	0.3	21	0.5
2. Other investment purposes	20	3.7	138	6.9	350	7.9
Sub-Total	23	4.3	144	7.2	371	8.4
Grand Total	543	100.0	1984	100.0	4393	100.0

- ***Deposits from General Public***

BAAC's public deposits have grown at 30.5 per cent per annum during the fiscal year 1985 to 1990, faster than any other source of funds. From 12.6 per cent of BAAC total resources in FY 1980, to about 37.0 per cent in FY 1990, this impressive development is the outcome of a rural saving mobilization campaign launched by BAAC back in 1981 to be complemented later by a salary incentive system which assigned to it the highest points (weight) to the branch which deserved a merit increase.

- ***Deposits from Commercial Banks***

Such deposits provided 25.6 per cent of BAAC's source of funds. Although BAAC pays the prevailing market interest rate for these deposits (according to government's policies for mandatory allocation of commercial bank credit for agriculture), there is an element of subsidy in that BAAC does not have to incur any costs in raising these deposits.

- ***Borrowings (Mainly from Foreign Sources)***

At the end of FY 1990, borrowing stood at about 10.0 billion baht of which OECF provided 51 per cent, IBRD, 35 per cent, IFAD, 5 per cent, ADB, USAID and KFW together, 4 per cent, and domestic sources (excluding commercial banks, Bank of Thailand and public deposits), 5 per cent.

- ***BAAC equity and Bank of Thailand soft loans***

These represent subsidized sources of funding for BAAC. Its equity is a subsidized source because it is not required to pay any dividends and included grants of 957 million baht and 234 million baht made by EEC and the government respectively. The Bank of Thailand preferential interest rate loans to BAAC, made to finance its programmes, have about 4,896 million baht or 8.6 per cent in FY 1990.

Table 12.2.7

PROJECT-TYPE CREDIT OPERATIONS
As at the End of Fiscal Year 1990

Type of Project	No. of Projects	Farmer (person)	Volume of work (rai)	Loan Disbursement (Million Baht)	Cumulative Collection of Principals (Million Baht)	Outstanding Principals (Million Baht)	Repayment Rate During the year (%)
1. Credit projects implemented in response to policy directives from government	17	885025	749	13373.2	10124.16	3249.04	96.97
2. Integrated projects involving government agencies, private sectors companies and BAAC	65	191692	1101532	1604.24	632.36	971.88	93.5
2.1 Full cycle	58	106503	1101532 106 animals	820.98	500.41	320.57	95.2
2.2 Other	7	85189	-	783.26	131.95	651.31	87.28
3. Special projects	168	62238	697259	2494.61	855.42	1639.19	61.18
3.1 Special projects implemented before FY 1989	145	53430	667791 34,731 animals	2283.7	831.08	1452.62	58.94
3.2 Special projects commencing in FY 1989	23	8808	29468 2,541 animals	210.91	24.34	186.57	not yet due
Total	250	1138955	1799540 37,378 animals	17472.05	11611.95	5860.11	92.73

Table 12.2.8

BAAC'S SOURCE OF FUNDS

(Million Baht)

Source	1980 Amount	1980 %	1985 Amount	1985 %	1986 Amount	1987 Amount	1988 Amount	1989 Amount	1990 Amount	1990 %	Average Growth Rate (%) 1980-85	Average Growth Rate (%) 1985-90
Shareholders' Equity	2,037	11.1	2,657	9.1	1,849	1,978	3,218	4,046	5,036	8.9	5.5	13.6
Deposits from the general public	2,301	12.6	5,548	18.9	7,118	8,812	11,459	15,986	20,971	37.0	19.2	30.5
Deposits from Commercial Banks	7,187	39.2	10,685	36.4	11,113	13,540	14,395	14,509	14,514	25.6	8.3	6.3
Borrowings	2,035	11.1	6,369	21.7	7,808	7,133	7,043	8,209	9,985	17.6	25.6	9.4
Bank of Thailand	4,500	24.5	3,500	19.2	6,348	3,000	3,000	4,310	4,896	8.6	-4.9	6.9
Others	279	1.5	600	2.0	687	626	927	1,031	1,326	2.3	16.5	17.2
Total	18,339	100.0	29,359	100.0	34,923	35,089	40,042	48,091	56,728	100.0	9.9	14.1

III. The Role of the Bank of Thailand in Long-Term Financing for Agricultural Sector

3.1 Financing Facilities

Since 1967, Bank of Thailand has been authorized to rediscount promissory notes arising out of agricultural transactions. The rediscounted loans were for (a) agricultural production/husbandry, (b) agricultural product trading, and (c) Rural Development credit refinancing. The first two rediscount facilities are usually short term and the third is medium to long-term in nature. For agricultural production, the banking system (including BAAC) may have 50 per cent of their loans rediscounted at 5 per cent per annum and the maximum rate the banking system may charge the subborrowers is 10 per cent per annum. For loans for agricultural product trading, the rediscount rate is 4 per cent but the maximum lending rate remains 10 per cent. For these two facilities, a maximum limit per banking institution is reviewed every six months. The rural development facility, started in FY 1988/89 is essentially an investment project financing facility with 50 per cent of the promissory note (up to five years or seven years for special projects) drawn by the project owner to be rediscounted at a maximum rate of 3 per cent per annum and relent at a maximum rate of 10 per cent per annum. Details of Bank of Thailand rediscount facility are give in Table 12.2.9.

3.2 Regulations

3.2.1 Mandatory Lending for Commercial Banks

The most prominent vehicle to achieve government's goal of expanding credit for the agricultural sector is to require commercial banks to lend a percentage of their deposits to this sector. It began in 1975, when banks were mandated to allocate 5 per cent of their previous year's lending; shortfalls were to be deposited with BAAC. Increased to 7 per cent of the previous year's total deposit in 1976, the rate was gradually increased to 11 per cent by 1978 when an additional 2 per cent lending for agri-business/agroindustries was also mandated. These mandatory rates remained unchanged until 1987, when they were increased to 20 per cent (14 per cent for direct lending to the rural sector and 6 per cent for agri-business). The new definition of "direct lending" to the rural sector allowed the commercial banks to include in the

Table 12.2.9

BOT REDISCOUNT FACILITIES FOR AGRICULTURE/RURAL DEVELOPMENT

(Billion Baht)

Type of Facility	Annual Disbursement					
	1980	**1985**	**1986**	**1988**	**1989**	**1990**
Ag. Production	0.88	0.51	0.68	1.24	1.72	1.946
– Animal Husbandry	(0.88)	(0.51)	(0.58)	(0.63)	(0.82)	(1.80)
– Sugar cane	(-)	(-)	(0.10)	(0.61)	(0.90)	(0.14)
Ag. Product Trading	6.62	(-)	1.00	6.09	4.22	4.851
– Paddy	(n.a.)	(-)	(n.a.)	(6.09)	(4.22)	(4.851)
– Others	(n.a.)	(-)	(n.a.)	(-)	(-)	(-)
Rural Development	-	-	-	-	-	1.127

quota loans to small scale rural industries (SSRI's) and to finance the cost of rural inhabitants' job search (and installation) in the middle East.

3.2.2 Relaxation of Restrictions in Opening of Commercial Bank Branches

The relaxation is that every commercial bank is allowed freely to open new branches in rural areas where there is no existing commercial bank branch and if its financial statement is sound. The previous control to open a new commercial bank branches is rather tight and depend on the annual quota set by the Bank of Thailand. This quota will take into account the past performance of each bank.

In order to enable these branches to fulfill the credit requirements of rural areas, the Bank of Thailand has stipulated that each new branch in rural areas must lend out a minimum of 60 per cent of its deposits to the locals and at least one-third of this amount must be granted to farmers. The branches that cannot comply with this condition must deposit their money with the Bank of Thailand bearing no interest.

3.2.3 Impacts of Agricultural Credit Policy

Expansion of Loan to Farmers

The volume of agricultural credit from institutional sources has increased enormously and widely after agricultural credit target for commercial banks was set by the Bank of Thailand in 1975. Apparently, two financial institutions which are active in providing loans to farmers are:

(1) The BAAC, which had extended loans to farmers from 3,355 million baht in 1975 to 40,040 million baht in 1990. This was counted about 12 times during the past 15 years. During the same period, the long-term loans disbursed by BAAC had growned about 47 times (Table 12.2.5).

(2) Commercial Banks had extended loans to farmers from about 2,234 million baht in 1975 to 155,836 million baht in 1990. Such loans had increased more than 70 times during the past 15 years (Table 12.2.10). Although the overall target had been almost achieved by commercial banks which could extend credit to farmers, there were still a number of banks that were unable to meet their individual target in some particular years.

Restructuring and Establishing of Agricultural Credit Unit in Commercial Banks

In order to accelerate credit for farmers to meet their targets, some commercial banks set up the agricultural credit centers in their head offices. The functions and responsibilities of the center include the allocation of agricultural lending volume to their rural branches. Besides, the center has to train field staffs of the bank in loan processing and preparing agricultural lending report required by the Bank of Thailand. Those commercial banks are namely; The Bangkok Bank Limited which had promoted its former Agricultural Credit Division to be an Agricultural Credit Department in 1981, The Krung Thai Bank, Ayudhya Bank, Thai Military Bank, Bangkok Metropolitan Bank, and Thai Danu Bank which had set up their agricultural credit division. There are only six medium and small Thai commercial banks which have yet to set up any agricultural credit sections in their head offices.

Table 12.2.10

MANDATED TARGETS AND ACTUAL LENDING OF COMMERCIAL BANKS FOR AGRICULTURAL SECTOR, 1975-90

(Million Baht)

	Actual Lending		Mandated Target		Lending Shortfall		Deposit with BAAC	
	Amt.	% of Dep.	Amt.	% of Dep.	Amt.	% of Dep.	Amt.	% of Dep.
1975	2,234	3.2	4,333	6.2	2,099	3.0	1,682	2.4
1978	8,100	6.2	11,771	9.0	3,671	2.8	5,511	4.2
Av. 1979-81	12,029	6.6	20,060	11.0	8,031	4.4	7,045	3.9
Av. 1982-84	28,233	8.5	35,988	11.0	7,755	2.5	8,915	2.8
Av. 1985-86	38,907	7.5	57,084	11.0	18,177	3.5	10,899	2.1
1987	55,864	9.0	86,932	14.0	31,068	5.0	12,340	2.0
1988	73,211	9.8	104,111	14.0	30,900	4.2	14,119	1.9
1989	99,983	11.3	123,809	14.0	23,826	2.7	14,486	1.6
1990	155,836	13.9	157,246	14.0	1,410	0.1	14,503	1.3

Agricultural Project Lending

The other consequence of establishment of agricultural credit target is that commercial banks have found an efficient mean of granting loan to project undertakings. They have learned from past experiences that lending to scattered small farmers is costly and cannot be supervised according to their requirement. Some banks cooperate with private firms in providing loans to large projects in order to reduce high risk. In 1977 Bangkok Bank Limited and Bangkok Farm Co., Ltd., gave financial assistance and management services to a piggery farm project in Chacherngsao Province, about 100 kilometres east of Bangkok. This farm consisted of 34 selected tenant farmers. The size of this farm was about 1,000 rais (2.5 rais equal to 1 acre). The Bangkok Farm provided land improvement, farm houses, pig houses and many necessary inputs for farmers. According to this project, farmers were granted loans by Bangkok Bank to purchase land. Since farmers are not familiar with modern farm management, the Bangkok Farm had to manage this farm on behalf of them up to a certain period of time. Farmers who undertook this project used their labour and worked under the control of the Bangkok Farm. The other lending project of Bangkok Bank was also a piggery farm in Chantaburi Province, about 300 kilometres east of Bangkok, but this project consisted only of disable soldier families.

The other commercial banks that also implement project lending are Thai Farmers Bank, Siam Commercial Bank and Thai Danu Bank. But the project lending of these three banks are not considered to be the ideal model because the banks only gather the borrowers of the nearby areas into groups and simply grant loan to them. The Banks do not provide other services to these groups.

Management of Agricultural Credit at Rural Branch Level

Many commercial banks realise that in order to meet the loan target, it is necessary for them to encourage their rural branches to extend loan to farmers. In addition, supervised credit should be applied to small farmers. Bangkok Bank and Krung Thai Bank provide agricultural loan officers to work in every branch in rural areas. So the volume of credit of these two banks is widely extended and the quality of loan has improved. However, it may be noticed that the management of credit in rural branches has developed significantly. For instance, instead of waiting for clients in the office, the bank will send its loan officers to visit its scheduled clients in order to assess their collateral and remind them of debt settlement after selling their products. Currently, there are many banks taking the initiative to develop credit management because they realised that they can lose their clients easily if their credit management is inefficient.

3.3 Supervision Problems

The Bank of Thailand, when first mandated commercial banks lending to farmers in 1975, had no legal power to direct commercial banks to lend their loanable fund to any specific sector. Thus, moral suasion was used to request commercial banks to follow agricultural credit policy. Though the Bank of Thailand, currently, has the authority to direct commercial banks to extend credit to any sector, moral suasion is still being used in encouraging commercial bank lending to farmers. Other wise, the mandated lending is a widely broad definition by not specifying any percentage of long-term loan included in the target. The commercial banks had no difficulties in satisfying the long-term lending target of the Bank of Thailand.

As for BAAC, as mentioned earlier, operates lending under the Charter incorporated in the BAAC Act of 1966 and is controlled by the Board of Directors which is chaired by the Ministry of Finance. The overall BAAC's operation is sound and well managed.

In project analysis proposals, commercial banks and BAAC are free to undertake and make approvals. But they are requested to provide credit on concessional terms to farmers participating in various government sponsored projects e.g. projects in response to natural calamities, agricultural development projects, and integrated projects formulated and implemented jointly with relevant government agencies and private companies.

3.4 Implications for the Bank of Thailand

The impact of the mandatory lending policy is hard to quantify and materialize. However it has some distortionary effect for commercial banks. For commercial banks' "directed lending" has always fallen short of government's target; they have always achieved, on the other hand, the target for lending to agri-business. Despite the measures taken to broaden the definition of direct lending in 1987, the shortfall has continued to increase. In addition, interest rate ceilings for the commercial banks have served to restrict the coverage of their clients in the sector. They have essentially penalized potential clients who may be willing and able to pay higher rates for riskier, but potential viable, investments. In the non-agricultural sectors, higher risk investment have been able to obtain loans from Finance Companies which can lend at an interest rate of up to 21 per cent, but such options are seldom offered to agricultural borrowers.

The role of the Bank of Thailand, however, is necessary because there is a large proportion of farmers amounting to 30 per cent which is outside the scope of organized financial institutions. These farmers have to look for loans from private individual creditors who charge extremely high interest. The interest can be as high as 5 per cent a month or 60 per cent per annum. In fact these farmers have encountered bad experience by becoming invariably indebted to various money lenders.

Consequently they ended up cultivating their crops from year to year, yielding barely enough from maintenance after re-paying of their debts and losing part of their land each year, because their indebtness to money lender becomes too burdensome. Whatever attempts are to be employed in dealing with this situation in order to brighten the prospects for the back-bone of the country, the problems prevailing in this sector must first be resolved.

IV. Issues and Suggestions

4.1 Factors Limiting Access to Institutional Credit

Farmers who need the most long-term financing from institutional sources tend to be the ones who are least qualified from the collateral point of view. Any farmers, on the other hand, who can provide the collateral to secure their loans can turn elsewhere for financing. Furthermore, there are so many factors that limit farmers' accessibility to long-term institutional credit. These constraints are lending practices and attitudes, potential or opportunity to invest, initiative idea to identify and formulate programme etc. In this regard, long-term financial needs for the agricultural sector are not met by credit institutions.

4.2 Repayment Problems

Little information is available on loan repayment to commercial banks, and what is available is outdated. The commercial banks' loan repayment system is apparently under good control and thus the bad debts are suprisingly small in amount (ratio of past due loans and liquidation is about 4 per cent). Those having problems are permitted to reschedule their repayment.

As for BAAC, the collection rate for short-term loans (85-88 per cent) is better than that for long-term loans (72-84 per cent). The repayment performance of both long-term loans for financing old debts and for investment in agriculture has been increasing (Table 10.2.11). This is due to the expansion by BAAC of its credit operations in the form of special projects to develop the agricultural sector and to provide farmers with an opportunity to invest which require a large amount of capital and take several years to break even. Additionally, BAAC is very supportive of all efforts to increase farm incomes in order to enable borrowing farmers to make punctual repayments.

Table 12.2.11

LONG-TERM LOAN RECOVERY PERFORMANCE OF BAAC'S CLIENT FARMERS

(Million Baht)

	Principal Matured		Principal Repaid		Principal Deferred		Principal in Arrears	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
I. Long Term Loan for Refinancing Old Debts								
1980	74.31	100	37.91	51.0	31.33	42.2	5.07	6.8
1985	38.65	100	14.08	36.4	10.15	26.3	14.42	37.3
1986	31.85	100	12.19	38.3	6.45	20.3	13.21	41.5
1987	24.25	100	9.91	40.9	-	-	14.34	59.1
1988	18.43	100	9.00	48.8	-	-	9.43	51.2
1989	12.54	100	9.00	71.8	-	-	3.54	28.2
1990	4.90	100	3.23	65.9	-	-	1.67	34.1
II. Long Term Loan for Investment in Agriculture								
1980	444	100	306	68.9	119	26.8	19	4.3
1985	1,992	100	1,226	61.6	552	27.7	214	10.7
1986	2,287	100	1,562	68.3	474	20.7	251	11.0
1987	2,514	100	1,791	71.2	-	-	723	28.8
1988	2,702	100	2,109	78.1	-	-	593	22.0
1989	3,170	100	2,649	83.6	-	-	521	16.4
1990	3,248	100	2,701	83.2	-	-	547	16.8

The main reasons for default are attribute to unexpected household expenses, heavily in debt to private creditors, and others (i.e. repayment for short term loans which are being accorded priority) (Table 10.2.12).

4.3 Future Needs of Long-Term Financing

There are several studies relating to the credit need of farmers. The first and the most comprehensive study was conducted in 1962 by Pantum et al. The study approach is an economic survey of Thai farmer's indebtedness within a certain time frame. Pantum reported that 68 per cent of the surveyed farmers were in debt. The average debt per farm family was 3,717 baht and the total amount on debt was 9,122 million baht. Evidence also showed that the credit need is increasing over time. The Bangkok Bank predicted in 1976 the basic credit need of Thai farmers was at least 20,000 million baht of which 4 million farm families are in need of credit with each needing 5,000 baht. The Bank of Thailand

Table 12.2.12

REASON FOR CLIENT FARMER'S INABILITY TO REPAY LONG-TERM LOANS

	Refinancing Old Debts		**Investment in Agriculture**	
	No. of	**%**	**No. of**	**%**
Crop losses due to natural calamities	20	2.9	301	2.9
Fall in market prices for agricultural commodity	–	-	215	2.1
Wilful default	16	2.3	443	4.2
Misuse of loan proceeds	6	0.9	555	5.3
Heavily in debt to private creditors	32	4.6	2389	22.9
Unexpected household expenses	405	58.5	3764	36.1
Loss of assets due to legal suit	27	3.9	1005	9.6
Other reasons	186	26.9	1757	16.9
Total	692	100.0	10429	100.0

estimated the minimum cash credit need for agricultural production to be about 25,000 million baht for the year 1977 by calculating the cash expenditure needed per area of production by crops. Since the three studies are of different nature and approaches, it may be dangerous to draw any meaningful conclusion. However, the findings from these studies do indicate drastic changes in the magnitude of farm credit need over the past fifteen years.

It should be noted that the aggregative estimates of credit needs did not include long-term or investment credit. Theoretically and practically such estimates are extraordinary difficult to obtain as they would involve a great variety of agricultural development projects such as land consolidation, farm level irrigation, and livestock development. However, as the need for long-term credit has recently been recognized in Thailand and credit for this purpose is now available from credit institutions, there is clearly an urgent need for a research study to provide reliable estimates especially for policy-making and planning purposes.

4.4 Recommendations for Further Improvements

There is a need for massive external assistance, at this time, to increase the flow of long-term loans from institutional funds to agriculture. Currently, 70 per cent of Thai farm families are already utilising institutional credit. But in practice the long-term loans provided by BAAC amounted to 16 per cent of the total disbursement and that commercial banks provided 11 per cent of the total outstanding to agriculture. Efforts are needed to improve and consolidate the agricultural credit system before undertaking additional expansion.

The lack of research study on long-term credit needs of Thai farmers is very unfortunate as it will certainly affect the effectiveness of the planning and the implementation of the credit policy. Since the overall need for this purpose is too difficult to estimate, it may be advisable to identify certain long-term agricultural projects and their financial requirements. For example, a livestock project may be identified and analysed using cost-benefit procedures, thus, credit requirements may be calculated. Farm-level land developments are other projects of long-term nature which should be of interest among policy makers. In fact, the proposed (multi-period) Linear Programming model can be extended to include investment activities which must be partially financed through borrowing. The model will certainly become more complicated. The computer facilities must therefore be accessible for the analysis.

As very little is known about rural savings behaviour in Thailand, research on this should be undertaken. It has been recognized that the promotion of rural savings is also essential for the fulfillment of the increasing credit demand. It should be conducted every year for a period of, say, ten years to generate time series data.

It should be noted that studies on supply of credit is as important as demand for credit. The drastic change in the credit policy will have a great impact upon the structure, the conduct, and the performance of the rural capital market in Thailand. A study on such impact will be necessary and useful to agricultural development.

V. Major Findings and Concluding Remarks

Obstacles and constraints preventing a more rapid expansion of long-term lending for agriculture and those inhibiting and limiting farmers' borrowing from organized credit institutions exist as follows:

5.1 Lending Procedures and Attitudes

(i) Most of the commercial bank lending emphasize on short-term loans because the banking community defines agricultural credit to include "bills, loans and overdrafts". A large proportion of lending was done on the basis of overdraft facilities (about 33 per cent) which is preferred by banks as well as borrowers since these facilities are relatively simple to operate and convenient for both sides. Moreover, the overdraft facilities are extended to established account holders and limits are determined upon the relationships between the banks and the clients. Nevertheless, the system has prevailed in Thailand as in several other countries for a long time and the extensive use of term lending, however, desirable, will take a long time.

(ii) Credit institutions advanced long-term loans for farmers against securities in the case of individual farms. According to the survey made by the Bank of Thailand in early 1980 most of the commercial banks' branches preferred to deal with individual farmers than farmer groups. Where loan recovery risks are high as well as having joint liability, loans cannot be arranged. This is due to collateral factor and the complexity of group management.

5.2 Land Tenure

This problem is a collateral related problem. According to the recent study of World Bank, all long-term lenders generally use land as collateral. Since land titles and land documents accepted by credit institutions (NS-3 or NS-3K) have so far been issued to only about 57 per cent of the area under agricultural holdings. Commercial banks, therefore, opted for lending to large farmers who can offer clean collateral, or to farmers whose primary source of income is non-agricultural. The BAAC has focused the bulk of its lending efforts on joint liability groups of medium to small farmers rather than lending to single individual or through cooperatives or farmers associations.

In expanding long-term loans to farmers who have no land document, the framework of "special investment project" secured by joint-liability agreement is applied. But even where loan security is based on joint liability, the bank still needs to know that farmers applying for long-term loans will continue to have access to the land where they plan to implement their projects, and will not be evicted.

To provide this assurance, tenancy agreement must cover the repayment period of the loans, possibly 10 years; and farmers in degraded forest reserve areas must have valid land cultivation certificates from the Royal Forest Department. In practice, few of the farmers in degraded forest areas have these certificates, so most of them cannot qualify for long-term loans even in special projects where security is base on joint liability.

Problems like this can be found throughout the country, except that very few such areas benefit from the efforts of a project supported by an international donor, so progress can be expected to be even slower. The incomplete and slow documentation of land in the degraded forest areas are a major constraints on long-term investments in the land.

5.3 Identification and Formulation of Project

Although credit institutions found that providing long-term loans under special project framework is an efficient way, in practice there are many operational problems. The first and perhaps the most important problem is how to identify a project for possible financial assistance in the form of a long-term loan. How to make judgment on which type of farming is the best for a particular situation? To be able to make the right decision, the project identifier needs to obtain a background experience of the various existing types of agriculture, plus a good knowledge of the socio-economic profile and physical geography of the project area. Such skills and experience cannot be acquired in only a short space of time.

Another problem is that in general it is difficult to persuade small scale farmers to undertake new farming activities which require long-term loans. BAAC's experience, for instance, special arrangements were made to provide technical and marketing support through public and private agencies, and the bank publicised the projects on the local radio and TV stations and with posters and other printed materials. Despite all this, few of the branches were able to fulfill their recruitment and lending targets for these projects, particularly in the first year of the programme. There are of course many reasons for the shortfall which are beyond the Bank's control. The important factors are the lack of co-operation among other related government units, the need for improvement in infrastructure, the weakness of technical support services, and the market services for new farm products. Therefore, it is necessary to be consulted and to join with others in such a formulation exercise from the very beginning to ensure that the projects can survive.

5.4 Mandatory Lending Policy

Since the inception of mandatory lending, commercial banks "directed lending" has always fallen short of government's targets (see Table 10); they have always achieved, on the other hand, the target for lending to agri-business. Despite the measures taken to broaden the definition of direct lending in 1987, the shortfall (as a proportion of previous year's total deposits) has continued to increase because the contribution of SSRI lending and financial support for Middle East employment have not been able to keep up with the increased deposits and consequently the ever increasing level of mandated targets.

The basic reason for the shortfalls is that many of the smaller commercial banks have very few branches in the rural area. However, even where banks have such branches, other mandatory requirements of the Bank of Thailand have compounded the problem. First, 60 per cent of the deposits mobilized at each branch has to be lent in the local area. Second, a third within this 60 per cent (i.e. 20 per cent) has to be for direct lending to agriculture. If these conditions are not met, all shortfalls have to be deposited at the Bank of Thailand without interest. In addition, there are other causes inhibiting the expansion of commercial banks branch lending to the targetted local area. These causes could be classified as potential agricultural activities, number of settled down agricultural households, ability to borrow and debt repayments of farmers, and the development of infrastructure in each locality.

The mandated targets do not either include or specify the proportion of long-term loans for agriculture that were secured by commercial banks. To a large extent, it only stipulated commercial banks to increase the supply of credit to farmers alone without complementary measures in long-term loans development for the agricultural sector.

It is questionable whether such long-term loans should be mandatory for commercial bank lending. It may have increased the complexity in banks operations and the volume of the shortfalls. However, in encouraging commercial banks to extend long-term loans to farmers the Bank of Thailand has to move one step further by formulating a loan guarantee policy. This policy will help to reduce the importance of the risk factor and to increase the credit supply from institutional sources.

5.5 Rediscount Facility for Rural Development

This facility is usually medium term and the maximum maturity to refinance is 5 years. Its aim is to support agricultural development projects and to promote small industries schemes in rural areas. Commencing in 1989 promissory notes discounted under this facility are not active. But in 1990 the approved volume of eligible promissory notes to discount with the Bank of Thailand is 1.1 billion baht (total of 11 projects). The sluggish response of commercial banks to this rediscount facility is due mainly to the relatively high costs and low rates of returns of agricultural loans. Furthermore, it is probably due to the projects being considered; e.g. production of dairy products, chicken, tiger prawns, rice, baby corn and cashew nuts, are the usual projects which can be handled by the commercial banks and BAAC independently and should, in any case, not be singled out for additional subsidy support. Given these concerns, the Bank of Thailand should re-examine the objectives and performance of rural development rediscount facilities and its appropriate role in its operation.

5.6 Interest Rate and Financial Policies

There are no restriction on commercial banks' lending rate to farmers except that the rate has to be within the overall ceiling (presently, 19 per cent per annum). In practice, however, commercial banks charge their agricultural loans between 16 per cent to 19 per cent per annum.

In its lending to small farmers under special programme in cooperation with government agencies, commercial banks generally have to charge lower interest rate of between 15-16 per cent per annum. Even with various kind of indirect support provided by the government, the interest rate is not enough to cover certain essential costs of lending. From the bank's point of view, the costs to be recovered are administrative costs, cost of capital, allowance for default and allowance for rate of inflation.

Taking these cost factors into consideration, the US-AID Spring Reviews suggest that 18 per cent may be regarded as a minimum loan rate if subsidy to lending operations is to be avoided. In many institutions this could hardly be done for less than 24 per cent. Since even the 18-24 per cent range is still lower than most of the money lenders' rate, it would not deter most farmers from using such credit, if quality of the credit services can be improved. If credit institutions are allowed to charge flexible interest rate with a spread large enough to cover the higher risks and administrative costs of lending to small farmers under the special development projects, the formal credit institutions will play an important role in providing long-term loans to small farmers as well as the agricultural sector.

BAAC's commercial viability is constrained by limitations imposed by the government on its lending rates, although these rates are officially set by its own Board. The BAAC would not have operated profitably under its prevailing interest rates (12.5 per cent for short and medium term loans, 11.5 per cent for long-term loans and between 3 per cent to 11.5 per cent for special projects) without the following indirect subsidies:

(a) soft loans from the Bank of Thailand and specially constituted development lending funds provided at subsidized interest rates;

(b) exemption from corporate taxes;

(c) no mobilization cost on the substantial deposits that it received from commercial banks; and,

(d) the non-payment of dividends from its profits. Interest rate ceilings for BAAC have not only restricted the coverage of its clients but, because they are also below commercial bank rates, have created distortions detrimental to the commercial credit sector. If BAAC is allowed to charge the rates commercial banks do, it would not need the tax exemption and most of the other subsidies it currently enjoys.

Bibliography

Asian and Pacific Regional Agricultural Credit Association (APRACA), *Agricultural Credit Operations, Reports of APRACA Staff Exchange Fellows* (1982), May 1983.

APRACA, "Thailand", *Agricultural Credit Policies and Programmes for Small Farmer Development in Asian and Pacific Countries, Countries Profiles 1978,* June, 1979, pp. 130-140.

Bank for Agriculture and Agricultural Cooperatives (BAAC), *Annual Report* 1984, 1985, 1989.

BAAC, 22nd Year of Operations 1988, Bangkok 1989.

Bank of Thailand, Task Force on Agricultural Credit Development, "Agricultural Credit in Thailand", Bangkok, May 4, 1977.

Lee, Chong Yeong, "Improvement of Agricultural Banking Practices for Small Farmer Credit Programme", Paper presented at the Seminar on Agricultural Credit Policy and Programs in Thailand, Bangkok, December 22-23, 1977.

Lightfoot, Paul "Agricultural Bank's Long Term Problem and Solution", Article presented in The Nation (Thailand's Newspaper), May 22 and 24, 1991.

Meyer, Richard L. etc. al. "Agricultural Credit in Thailand" Center for Applied Economic Research, Kasetsart University, May 1979.

Onchan, Tongroj, "Credit Needs of Thai Farmers", Kasetsart University, paper presented at the Seminar on Agricultural Credit Policy and Programs in Thailand, Bangkok, December 22-23, 1977.

Sakornratanakul, Sirichai et. al. "A Review of Financial Policies in Thailand to Promote Access of Farmers to Institutional Finance", Paper presented at the 18th APRACA Executive Committee Meeting and 10th Foundation Anniversary, November 11-14, 1987.

Tohtong, Chamlong, "Long-Term Lending for Agricultural Development", in *Me and BAAC* (Thai Version), October 15, 1971, pp. 111-116.

World Bank "Agricultural/Rural Credit and The Bank for Agriculture and Agricultural Cooperatives", in *Thailand Financial Sector Study,* Volume 1, May 25, 1990, pp. 123-141.

DEMAND FOR LONG-TERM LOAN FROM IFCT
1980-1990

Year	TGDP	LTLA	AIR
1980	299.50	1,027.48	14.44
1981	318.40	1,208.62	15.07
1982	331.40	1,037.48	15.03
1983	355.40	1,574.59	14.08
1984	380.70	2,211.45	14.43
1985	394.10	3,007.23	14.49
1986	411.80	1,449.75	13.45
1987	446.40	2,264.45	11.86
1988	495.40	2,276.50	11.72
1989	548.90	3,550.50	13.28
1990	603.80	3,531.10	13.58
Average Growth Rate (1980 - 1990)	+7.3	+13.1	

TGDP = Thailand's real GDP, Unit = Billion Baht
LTLA = Long-term Loan Approved, Unit = Million Baht
AIR = Average Lending Interest Rate, Unit = %

Source: Industrial Finance Corporation of Thailand.

Appendix 12.2

Institutional Structure

	Apex Institutions		Other Institutions	
	Commercial Bank	BAAC	Agri. Co-operatives	Reg'd farmers groups
At Village level (5 million farm families)	Agricultural loans 649,394 clients	Informal groups 1,897,525 clients	Informal groups 833,771 members	Registered groups 84,145 members
At district level (576 Districts in Thailand)	Branches	604 offices	812 Co. ops.	
At National level	Branches	118 Branches	20 Federations Rice Mills Storage, etc.	
Central Bank Involvement	Head Offices	Head Offices	1 National Federation For Supply & Marketing	1 Marketing Org. For Supply & Marketing
	Central Bank discount and rediscount facilities Available for production, marketing, supply and livestock		No direct Involvement	No direct Involvement
Extension Services	Government (MOAC) and own	Government (MOAC)	Co-op. Promotion (MOAC)	Ext. Services Dept. (MOAC)

(BAAC = Bank for Agriculture and Agricultural Co-operatives)
(MOAC = Ministry of Agriculture and Co-operatives)
(ACFT = Agricultural Co-operatives Federation of Thailand)
(Numbers quoted above reflect position as at 31 March 1990)

AGRICULTURAL CREDIT EXTENDED BY COMMERCIAL BANKS

(Outstanding Amount at Year-end: Million Baht)

Years	Target	Direct Lending	Deposit with BAAC	Lending to Agribusiness	Total Lending	Amount of Shortfall 6/
1975	3,500.0	2,233.6	1,681.8	-	3,915.4	415.4
1976	6,139.0	3,810.9	3,160.9	-	6971.5	832.5
1977	9,647.0	5,891.8	4,528.0	-	10,419.8	772.8
1978	11,771.0 1/	8,099.5	5,511.4	-	13,610.9	-
	14,387.0 2/	8,099.5	5,511.4	6,382.5	19,993.4	1,803.6
1979	17,322.4 1/	9,970.0	6,330.1	-	16,300.1	-
	20,472.0 2/	9,970.0	6,330.1	7,755.8	24,055.9	(1,092.1)
1980	19,208.7 1/	11,553.1	7,000.3	-	18,553.4	-
	22,701.2 2/	11,553.1	7,000.3	9,962.2	28,515.6	523.6
1981	23,649.3 1/	14,456.7	7,803.9	-	22,260.6	-
	27,949.2 2/	14,456.7	7,803.9	9,932.1	32,192.7	(86.6)
1982	28,293.7 1/	20,140.4	8,405.2	-	28,545.6	-
	33,438.0 2/	20,140.4	8,405.2	10,706.4	39,252.0	1,316.0
1983	35,330.0 1/	28,613.2	8,806.0	-	37,419.2	-
	41,753.5 2/	28,613.2	8,806.0	13,409.9	50,829.1	2,835.4
1984	44,340.9 1/	35,959.7	9,534.5	-	45,494.2	-
	52,402.9 2/	35,959.7	9,534.5	18,263.4	63,757.6	1,793.4
1985	53,819.5 1/	37,726.7	10,685.2	-	48,411.9	-
	63,604.8 2/	37,726.7	10,685.2	23,642.1	72,054.0	(5,455.4)
1986	60,347.6 1/	40,086.8	11,112.8	-	51,199.6	-
	71,319.9 2/	40,086.8	11,112.8	27,239.8	78,439.4	(9,264.2)
1987	86,931.7 3/	55,863.8	12,339.9	-	68,203.7	-
	124,188.2 4/	55,863.8	12,339.9	48,952.6	117,156.3	(19,996.4)
1988	104,111.4 3/	73,210.7	14,118.5	-	87,329.2	-
	148,730.6 4/	73,210.7	14,118.5	58,406.2	145,735.4	(18,044.0)
1989	123,808.7 5/	105,893.1	14,486.2	-	120,379.3	-
	176,869.6 4/	105,893.1	14,486.2	70,432.8	190,812.1	(5,017.4)
1990	157,245.9 5/	141,333.6	14,502.7	-	155,836.3	-
	224,636.8 4/	141,333.6	14,502.7	81,638.4	237,474.7	(5,403.3)

1/ Excluding agribusiness.
2/ Including agribusiness.
3/ Including small scale industries.
4/ Extending target to 20 per cent and redefining as rural credit.
5/ Including loans extended to credit union and saving cooperatives.
6/ Numbers in bracket are shortfalls of commercial banks which are unable to meet their targets.