

RURAL DEPOSIT MOBILIZATION IN THE PHILIPPINES, 1977 - 1986*

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Introduction

Government attempts to develop rural financial markets (RFMs) in the Philippines began in the early 1900s, apparently as a corrective response to the urban orientation of the colonial private banking system (Lamberte and Lim 1987). The long history of RFM development includes a series of government-initiated financial institutions, some of which exist until today. There are others which have been dissolved, their functions absorbed by newly created institutions. Like in many low income countries, several government financial institutions underwent "institutional recycling," the process of granting capital to highly subsidized agricultural lending institutions which eventually go bankrupt, and then renaming them and/or merging them with another institution provided with fresh capital for the resumption of operations (Meyer 1985).

A major turning point in the approach to RFM development in the Philippines occurred in the 1950s when rural private entrepreneurs were encouraged to enter banking through government incentives provided by the creation of Rural Banks and private development banks. The 60s and the 70s targetted the development of one rural bank for each municipality. As part of government efforts to increase food production in the early 70s, this network was utilized in the expansion of rural lending using government and external funds.

It appears that much of the interest in expanding the rural bank network was not to increase rural access to financial services generally but rather to expand lending, particularly of government and donor funds to

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counter rural unrest and accelerate agricultural production. The fundamental reasons why rural lending was below socially optimum levels does not appear to have been systematically analyzed. Ultimately, however, the establishment of banking institutions in rural areas and their use as channels for government funds did not reduce nor counter the urban bias of financial development. As the phenomenon of institutional recycling indicates, certain shortcomings in this RFM strategy frustrated these efforts to increase rural access to a sustained, dependable flow of financial services.

The urban bias of financial development, i.e., the concentration of banking offices and financial services in urban areas that occurs in many low income countries, must be viewed in conjunction with the overall urban bias of economic development (Gonzalez-Vega and Camacho 1988). Government subsidy to the establishment of the rural banking network hardly compensates for the small share the rural sector receives from other public investments. Because of the absence of rural infrastructures and the wide geographical dispersion of economic units, transaction costs are naturally high in rural areas for both banks and their clientele. All these serve to hinder the development of the financial system.

Transaction-cost reducing innovations, including the realization of scope economies by financial institutions, is crucial to the generation of expected payoffs from government subsidies. Unfortunately, the schemes adopted during the first half of the 1970s emphasized the role of the rural financial institutions as conduits of subsidized funds to agriculture. As government targetted loans grew in importance in the portfolios of these institutions, intermediated funds in the liability side of their balance sheets declined correspondingly.

Rather than develop true financial intermediaries that realize scope economies by offering an increasing range of financial services, a dualistic structure of rural-based banking institutions emerged under the regime of subsidized credit. On one hand, government and quasi-government banks and subsidized Rural Banks emerged primarily as lenders in rural areas; on the other hand, private commercial and savings bank branches emerged as net borrowers, i.e., they generated more deposits than they lent to the community (TBAC-UPBRF 1981). When the presence of more profitable lending opportunities in urban areas causes the rural to urban flow of funds, then the urban bias of overall economic development accentuates the bias of financial development (as discussed by Gonzalez-Vega and Camacho). This also affirms criticisms frequently made about specialized agricultural lenders, especially government-owned institutions. Not only do these institutions fail to realize cost reductions through the simultaneous provision of lending and deposit services, they also forego opportunities to develop the skills of bank management in matching and

synchronizing resource inflows with credit transactions and in involving the deposit community as an additional source of pressure for bank accountability (Bourne and Graham 1984).

To obtain a better perspective of the impact of government efforts to reduce the urban bias of financial development in the Philippines, it is important to examine deposit mobilization performance. The progress made in rural deposit mobilization is a key indicator of the extent to which financial services have effectively penetrated rural areas. It also indicates the progress made in the development of genuine financial intermediaries, i. e., institutions that engage in intermediation between surplus and deficit units in rural areas. It provides a measure of the success of formal financial institutions in gaining the confidence of rural people and in reducing the cost of financial intermediation services. The extent to which intermediated funds are lent at market rates in rural areas rather than channelled through the banking system for urban investment signifies the extent to which investors perceive profitable rural investment opportunities. Furthermore, rural lending at market rates, demonstrates the value investors place on formal finance relative to traditional financial arrangements such as direct finance (as exemplified by informal money lending) and self-finance. Since the number of clients served by bank deposit facilities is usually several times the number who get loans, effective deposit mobilization can serve more people than subsidized lending.

The objective of this paper, then, is to document and describe rural deposit mobilization in the Philippines in view of recent government attempts to reduce the urban bias of financial development. The analysis covers the period of 1977-1986, a particularly interesting period to study rural financial developments. The mid-1970s represented the high point of government concern for rural finance, especially for farm loans typified by Masagana 99 and other special loan programs. This period also includes the downturn of the economy in the 1980s and the related contraction of financial services, the extreme financial stress experienced by many financial institutions, and the political turmoil and eventual change in government. These developments contributed to overall financial insecurity and could be expected to have a negative impact on rural finance.¹

1. Because of the turmoil and uncertainty during this period, it could be argued that the analysis does not reflect the true potential of rural banking. Both rural and urban perceptions about the value of holding financial assets in banks were probably influenced by this situation. It would be useful to analyze issues beyond the scope of this paper, such as the possible impact of careful supervision of banking institutions and deposit insurance on deposit behavior. But this paper documents the interesting performance of deposit behavior *in spite of* these several important problems that logically would be expected to discourage financial development generally and rural deposits specifically.

The 1977-1986 period is also one in which published data can be used to try to distinguish rural from urban banking operations, but important limitations must be kept in mind. The National Capital Region (NCR) is defined here as the "urban" area, while the rest of the country is considered "rural". The official Philippine definition of "urban" includes regional centers, chartered cities and other municipalities outside of the NCR, but the available financial data cannot be disaggregated to this level. This implies, therefore, an upward bias in some measures attributed to rural areas such as deposits and number of banking offices.

Another problem is that the published data apparently include, but do not distinguish, inter-bank/inter-branch/head office-to-branch transactions.² Ideally, these transactions should be analyzed separately because, during periods of substantial yield differentials between deposit instruments of varying denominations, small retail deposit institutions in rural areas may take advantage of arbitrage opportunities by making deposit placements with larger banks. A placement by a rural banking office with, say, a commercial bank branch in a neighboring rural town would double-count deposits in favor of rural areas, while a placement with a bank in the NCR would credit both rural and urban deposits. In the case of loans, the location of the banking office that books the loan is not necessarily the locality where the proceeds are utilized. Large enterprises located in the hinterlands may have the headquarters of their credit operations in Manila. Thus, the rural-urban distinction of banking services used here must be interpreted as only a general indication of comparative financial development and performance of rural relative to urban areas.

The next section of the paper contains a brief review of the key determinants of rural deposit performance. Section three describes those aspects of the Philippine rural economy that could be very important in influencing rural deposit mobilization performance during the study period: rural income, accessibility of banking offices, and the relative attractiveness of deposit instruments considering inflation and the availability of alternative sources of funds for rural depository institutions. Rural deposit

2. The Central Bank of the Philippines periodically (annually, semestral, quarterly) publishes the *Regional Profile of Banks* as a supplement to the *Factbook Philippine Financial System*. Aside from the number of banking offices, by type of bank in each region, selected balance sheet items (assets, loans, deposits) and - beginning in 1983 - income statement items are reported. Hence, the basis of the measures used here are end-of-quarter loans outstanding. Deposits include demand, savings, time, NOW (Negotiable Orders of Withdrawal) and trust accounts. The origin (households, firms/organizations, government, other banks) of deposits is not distinguished, and the data series do not indicate how the balance sheet items of foreign banks overseas branches of domestic banks are reported.

performance is analyzed in section four, and section five concludes the paper.

Determinants of Rural Deposit Performance

The factors considered important in determining rural deposits may be usefully categorized into the following: (1) those that determine the scope of opportunities for financial asset holdings; (2) those that influence the incentives for savers; and (3) those institutional factors that impinge on opportunities and incentives to save. The availability of data constrains the analysis to the factors of income, access and availability of alternative source of funds.

In a monetized economy, households are expected to demand deposits as part of their efforts to create a balanced portfolio of assets. As incomes rise, a larger proportion of household assets is expected to be held in financial form to facilitate the larger volume of transactions undertaken by the household. More importantly, the non-synchronization of income and expenditure flows provide the basis for holding financial assets in order to manage consumption possibilities optimally through time.³ At a given level of income, the incentives to hold a growing proportion of wealth in a financial form are conditioned by the relative risks and returns of financial assets, which may be implicit or explicit, pecuniary or otherwise. In this regard, factors such as inflation and the transaction costs associated with, say, a savings account can be viewed as negatively related to the demand for deposits since they tend to reduce the real returns of the asset.

The accessibility of a banking office to the household is relevant for at least two reasons: first, in offering deposit services to the community, the household's opportunity set is broadened in that the option to save/hold financial assets is made available; and secondly, when accessibility improves convenience and reduces the resources expended in conducting bank transactions, the incentive to save with the bank is increased. Thus, transaction costs can be expected to play a crucial role in influencing the rural household's demand for financial services. Conceivably, there is some threshold level of transaction costs at which it becomes beneficial for even a low income household to convert part of its cash/or commodity stocks into bank deposits.

The motivation of banking institutions to supply deposit services is influenced by the availability of profitable opportunities to invest deposits,

3. See Niehans for a discussion on the utility maximization based model of demand for financial assets.

and the availability and cost of alternative sources of funds. Government policies and regulations that impact on the nature, composition and size of a financial institution's assets and liabilities will shape its profit opportunities.⁴ They will also influence the return net of transaction costs that savers earn on their deposited funds.

Rural Income

The rural sector is the most dominant sector in the Philippine economy in terms of its share of total output and population (Table 1). As expected, much of the output in rural areas is agricultural whereas the urban output is entirely nonagricultural. Compared to the urban sector, aggregate rural income flows are larger and probably are characterized by relatively more seasonality and variability associated with monsoon agriculture. This situation implies that in the aggregate there should be greater rural demand for financial opportunities to manage production uncertainties through time, along with possibilities for capital accumulation that might facilitate investments for better production and income risk management.

On the other hand, rural income is much lower than urban income in per capita terms. Rural per capita GDP during the 1977-1986 period was about 30-35 percent of urban per capita GDP, and this is a reflection of the urban bias of economic development. Low incomes could represent a serious constraint to the rural household's opportunity for financial asset holding, but the heterogeneity of households provides scope for financial intermediation. In particular, the cash flow patterns of some households are asynchronous as a result of differences in cropping patterns, enterprise combinations, procurement and marketing strategies, consumption patterns and family life cycles (Meyer and Alicbusan 1984).

Banking Offices in Rural Areas

There were about 2,500 banking offices in rural areas in 1986, comprising 70 percent of the nation's banking network (Table 2). While this number was a 27 percent increase over the 1977 figure, urban branches grew even more rapidly so that the proportion of banking offices serving rural areas actually fell from 1977 to 1986.

The urban orientation of the banking system is even more pronounced in the bank density ratios which measure the number of inhabitants per banking office. At the peak number of banking offices, the density ratio in urban areas reached 5,500 inhabitants per banking office

4. The impact of regulation on the depository firm in a profit-maximization framework is extensively analyzed in Spellman.

Table 1
PHILIPPINES: SELECTED ECONOMIC CHARACTERISTICS
RURAL vs. URBAN^{a/}

Item	Range ^b
Real GDP (Billion 1972 pesos)	78.5 – 99.9
Rural Share (%)	68 – 70
Population (million)	44.57 – 56.0
Rural Share (%)	87 – 88
Share of Agric to GDP (%)	
Rural	37 – 41
Urban	0
Philippines	25 – 29
Share of Industry to GDP (%)	
Rural	24 – 29
Urban	51 – 54
Philippines	32 – 36
Real GDP per Capita (1972 pesos)	
Rural	1,306 – 1,520
Urban	3,771 – 4,975
Philippines	1,621 – 1,951

^{a/} In this and subsequent tables, "Phil" and "Philippines" are used interchangeably; "urban" refers to "NCR" or National Capital Region in the NEDA data series, or "Region IV" in the Central Bank data series. "Rural" refers to the rest of the Philippines outside of the NCR (NEDA data series), or outside of Region IV (Central Bank data series).

^{b/} The minimum and maximum values, respectively during 1977-86.

Source: See Annex Table 1.

Table 2
NUMBER OF BANKING OFFICES AND BANK
DENSITY RATIOS,
URBAN VS. RURAL, 1977 - 1986

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

^{a/} Year-end totals.

^{b/} In thousands of inhabitants per banking office the denominator is the yearend number of banking offices.

Source: Central Bank of the Philippines, *Factbook of the Philippine Financial System, Supplement, Regional Profile of Banks*, various years.
 National Economic Development Authority (NEDA), "Philippine Regional Income Accounts", mimeo.

in 1983 while the lowest ratio in rural areas was achieved at 17,100 per banking office in 1980. While there were improvements in rural access to banking offices during this period, these gains have been temporary. Throughout this period, the rural bank density ratio was more than twice the urban bank density ratio, and by 1986 was about the same level as it was a decade earlier.

Furthermore, the bank density ratio tends to mask the severity of the problem of lack of access to rural banking facilities. In 1983, when the rural density ratio was low, over 40 percent of the rural municipalities did not have a single banking office (Table 3). The scarcity of banking offices varied from region to region with the extreme cases found mostly in the Mindanao Regions — the farthest from Metro Manila. The data in Table 3 suggest a trend in recent years from multi-bank municipalities to one-bank municipalities, and from one-bank municipalities to unbanked municipalities.

The steady increase in number of rural banking offices up to 1983 and the decline thereafter suggests that banks encountered problems in sustaining viable rural operations during the period of economic downturn. Some rural banks closed when Central Bank rediscount facilities were suspended in 1984 and others operated at impaired levels.

Government efforts to develop the rural financial system have been successful in promoting a diversity of banking institutions. Numerically, Rural Banks (RBs) predominate in rural areas followed by commercial bank (KBs) branches (Table 4). Other types of banking institutions found in rural areas are private development banks (PDBs), stock savings and loan associations (SSLAs), savings and mortgage bank (SMBs) branches and specialized government bank branches (SGBs). Prior to the 1980 banking reforms, RBs, PDBs and SSLAs were not authorized to engage in branch banking so that most of their offices by definition are head offices. However, the head offices of most KBs, SMBs, and SGBs are located in urban areas.

The Relative Attractiveness of Deposit Instruments

Rural inflation rates have been somewhat lower than urban inflation in recent years but higher during periods of rapidly rising prices such as in 1973 and 1984 (Table 5 and Figure 1). The disincentive effects of inflation on financial development were most severe during the period of interest rate ceilings prior to 1981 when real deposit rates tended to be negative (Table 6). Depositors experienced negative real rates of return on their bank deposits during the latter part of the 1970s and only began to receive positive returns after interest rate regulations were relaxed.

The supply of deposit services offered by banking institutions is in-

TABLE 3
DISTRIBUTION OF MUNICIPALITIES IN RURAL AREAS,
BY NUMBER OF BANKING OFFICES, 1983 - 1986

YEAR	Total Municipalities	% of Municipalities		
		With >1 Bank	With 1 Bank	With No Bank
1983	1,423	16	44	41
1984	1,423	15	45	41
1985	1,465	14	42	44
1986	1,469	14	42	44

Source: See Annex Table 2.

TABLE 4
DISTRIBUTION OF BANKING OFFICES, BY TYPE OF INSTITUTION,
URBAN vs RURAL, 1977-1986

Year	Type of Bank ^{a/}						Total ^{b/}
	KBs	SMBs	PDBs	SLAs	RBs	SGBs	
	(Percent)						
RURAL							
1977	34	4	4	6	48	4	1873
1978	34	5	4	6	47	4	2034
1979	34	5	4	7	46	4	2232
1980	33	5	5	8	46	4	2407
1981	36	2	5	8	44	4	2539
1982	38	3	6	8	42	4	2567
1983	38	3	6	8	42	4	2615
1984	37	3	6	8	43	4	2644
1985	38	1	6	7	44	4	2571
1986	36	3	6	7	43	4	2509
PHIL							
1977	45	7	4	6	36	3	2537
1978	44	7	4	6	35	3	2757
1979	44	7	4	7	35	3	3027
1980	43	8	4	7	35	3	3278
1981	47	5	5	7	33	3	3519
1982	49	5	5	8	30	3	3680
1983	49	5	6	8	30	3	3764
1984	49	5	6	7	30	3	3829
1985	51	3	6	6	31	3	3660
1986	48	6	6	6	31	3	3597

^{a/} KB = Commercial Banks
 SMB = Savings/Mortgage Banks
 PDB = Private Development Banks
 SLA = Stock Savings and Loan Associations
 RB = Rural Banks
 SGB = Specialized Government Banks

^{b/} The quarterly average number for the year.

Sources of basic data: Central Bank of the Philippines, *Factbook Philippine Financial System Supplement, Regional Profile of Banks*, various years.

Table 5
INFLATION RATES IN THE PHILIPPINES,^{a/}
RURAL AND URBAN AREAS 1973-1986

YEAR	PHILIPPINES	Urban	Rural
1973	0.18	0.12	0.21
1974	0.31	0.25	0.34
1975	0.08	0.10	0.07
1976	0.09	0.13	0.08
1977	0.07	0.07	0.08
1978	0.09	0.10	0.09
1979	0.15	0.13	0.16
1980	0.16	0.18	0.15
1981	0.11	0.13	0.10
1982	0.08	0.09	0.08
1983	0.12	0.11	0.12
1984	0.50	0.46	0.51
1985	0.18	0.21	0.17
1986	0.02	0.06	0.00

^{a/} Calculated as the annual percentage change in the Implicit Price Index for GDP (IPIN).

Sources of basic data: NEDA. "The Regional Income Accounts of the Philippines, 1972-1983" (mimeo).

_____. "The Regional Income Accounts of the Philippines, 1983-1985," Preliminary Estimates as of June, 1985, (mimeo).

_____. "The Regional Income Accounts of the Philippines, 1984-1986," Preliminary Estimates as of June, 1987, (mimeo).

Table 6
REAL RATES OF INTEREST ON BANK DEPOSITS,^{a/}
1977-1982

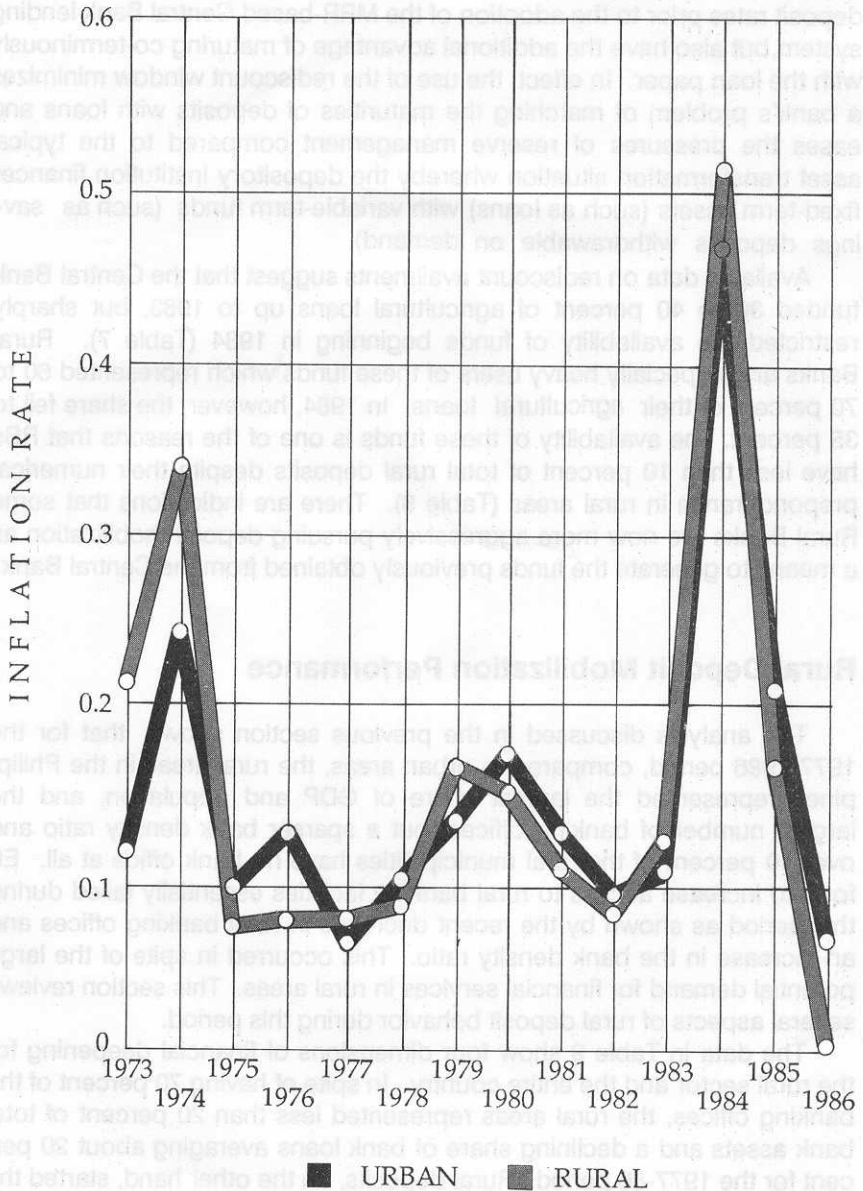
Year	Savings Deposits	Time Deposits
	(Percent)	
1977	(1.7) - (1.2)	(0.9) - 3.1
1978	(1.1) - (0.6)	(0.2) - 3.8
1979	(8.2) - (7.7)	(6.7) - (2.7)
1980	(5.9) - (5.4)	(0.9) - (0.4)
1981	(2.4) - 1.6	0.1 - 7.35
1982	0.2 - 4.2	2.7 - 9.95

^{a/} Computed as the nominal interest rate net of the inflation rate.

Source: Table 16 of TBAC, "Country Paper on Rural Savings Mobilization in the Philippines", 1984.

FIG. 1 ANNUAL INFLATION RATES

1973-1986



fluenced by the costs and risks of deposits compared to other sources of funds. Central Bank funds via the rediscount window are an important source of bank resources for agricultural loans especially for Rural Banks. Rediscount funds are frequently available at interest rates lower than deposit rates prior to the adoption of the MRR-based Central Bank lending system, but also have the additional advantage of maturing co-terminously with the loan paper. In effect, the use of the rediscount window minimizes a bank's problem of matching the maturities of deposits with loans and eases the pressures of reserve management compared to the typical asset transformation situation whereby the depository institution finances fixed-term assets (such as loans) with variable-term funds (such as savings deposits withdrawable on demand).

Available data on rediscount availments suggest that the Central Bank funded 30 to 40 percent of agricultural loans up to 1983, but sharply restricted the availability of funds beginning in 1984 (Table 7). Rural Banks are especially heavy users of these funds which represented 60 to 70 percent of their agricultural loans. In 1984, however, the share fell to 35 percent. The availability of these funds is one of the reasons that RBs have less than 10 percent of total rural deposits despite their numerical preponderance in rural areas (Table 8). There are indications that some Rural Banks are now more aggressively pursuing deposit mobilization as a means to generate the funds previously obtained from the Central Bank.

Rural Deposit Mobilization Performance

The analysis discussed in the previous section shows that for the 1977-1986 period, compared to urban areas, the rural areas in the Philippines represented the largest share of GDP and population, and the largest number of banking offices, but a sparser bank density ratio and over 40 percent of the rural municipalities have no bank office at all. Efforts to increase access to rural banking facilities essentially failed during this period as shown by the recent decrease in rural banking offices and an increase in the bank density ratio. This occurred in spite of the large potential demand for financial services in rural areas. This section reviews several aspects of rural deposit behavior during this period.

The data in Table 9 show four dimensions of financial deepening for the rural sector and the entire country. In spite of having 70 percent of the banking offices, the rural areas represented less than 20 percent of total bank assets and a declining share of bank loans averaging about 20 percent for the 1977-86 period. Rural deposits, on the other hand, started the period with 26 percent of total deposits; this share fell to 21 percent in

Table 7
RATIO OF AGRICULTURAL REDISCOUNT AVAILMENTS TO
AGRICULTURAL LOANS GRANTED, BY TYPE OF INSTITUTION
1978 - 1984

Type of Bank	Year						
	1978	1979	1980	1981	1982	1983	1984
	(Percent)						
Government Banks (PNB, DBP, LBP)	57.7	15.7	4.8	24.0	4.2	4.1	0.7
Private Commercial Banks	18.0	37.7	48.5	36.7	38.1	26.6	12.7
Thrift Banks	—	8.1	13.0	13.3	10.9	7.2	2.7
Rural Banks	66.4	67.8	70.8	68.9	73.7	69.3	35.4
ALL BANKS	32.3	36.6	43.2	39.0	37.0	29.9	14.5

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

TABLE 8
DISTRIBUTION OF BANK DEPOSITS IN RURAL AREAS,
BY TYPE OF INSTITUTION, 1977- 1986

Year	Type of Bank ^{a/}						Total ^{b/}
	KBs	SMBs	PDBs	SLAs	RBs	SGBs	
	(percent)						
1977	79.4	4.9	2.6	3.2	9.1	0.8	10.14
1978	77.5	6.4	2.5	3.6	8.9	1.1	12.75
1979	74.6	7.9	2.8	3.8	9.3	1.6	15.22
1980	74.1	7.4	3.0	4.1	9.2	2.4	17.34
1981	76.6	4.8	3.3	4.3	8.9	2.2	21.29
1982	76.7	4.4	3.9	4.6	8.1	2.4	29.86
1983	76.4	4.4	3.9	4.8	8.2	2.3	33.58
1984	79.1	3.0	3.5	4.0	8.0	2.4	36.76
1985	82.4	1.8	3.6	3.3	6.9	2.2	41.08
1986	79.5	4.4	3.7	3.2	7.0	2.2	48.02

^{a/} KB = Commercial Banks
 SMB = Savings/Mortgage Banks
 PDB = Private Development Banks
 SLA = Stock Savings and Loan Associations
 RB = Rural Banks
 SGB = Specialized Government Banks

^{b/} In billion pesos; the quarterly average volume for every year, except 1982 which shows a yearend balance.

Sources of basic data: Central Bank of the Philippines, *Factbook Philippine Financial System, Supplement, Regional Profile of Banks*, various years.

TABLE 9
DISTRIBUTION OF BANK ASSETS,
OFFICES, DEPOSITS AND LOANS,
URBAN vs. RURAL, 1977-1986

YEAR	BANK ASSETS		BNKG OFFICES		DEPOSITS		Bank Loans	
	Phil ^{a/}	% Rural	Phil ^{a/}	% Rural	Phil ^{a/}	% Rural	Phil ^{a/}	% Rural
1977	111.75	19	2,660	74	42.60	26	61.67	23
1978	140.75	19	2,888	74	53.84	26	77.19	22
1979	176.35	18	3,188	73	70.91	23	100.47	20
1980	209.89	17	3,411	73	88.25	21	118.12	20
1981	256.48	17	3,538	71	100.32	23	144.28	20
1982	312.09	17	3,689	70	123.99	24	162.06	21
1983	389.02	16	3,822	69	141.46	25	209.45	18
1984	465.11	14	3,791	69	153.14	26	212.74	16
1985	473.10	15	3,594	70	165.55	26	181.69	17
1986	486.15	17	3,581	70	174.34	31	185.08	18

^{a/} Yearend totals, amounts are in billion pesos.

Sources of basic data: Central Bank of the Philippines, *Factbook Philippine Financial System, Supplement, Regional Profile of Banks*, various years.

1980, then steadily rose to 31 percent by 1986. These data suggest two implications. First, the relation between share of banking offices and share of bank assets suggests that rural offices are comparatively small in terms of assets. Second, the relation between rural deposits and rural loans switched during the period. Through 1983, total rural loans exceeded rural deposits implying an urban to rural transfer of funds. From 1984 onward, however, rural deposits exceeded rural loans suggesting a reversal in the direction of flow of funds. This change occurred because rural deposits steadily rose during the entire period in spite of the decline in banking offices, while total bank loans peaked in 1984.

The relation between growth rates of real GDP, bank deposits and loans is analyzed and reported in Table 10. The overall period is broken into two subperiods divided at 1981 because the completion of interest rate deregulation on deposit instruments occurred in that year. Two distinct patterns emerge. During the first period, the growth rates in GDP, deposits and loans are all positive with the urban rates being relatively higher than the rural rates. Urban deposits and loans grew at rates of about 12 percent, almost double the rates experienced in rural areas. During the second period, all these growth rates are negative in both areas but there are important differences. The rate of decline in deposits is slower but the decline in loans is much faster in rural areas than in urban areas, thereby causing the rural to urban transfer of funds. One explanation may be that the banking sector is compelled to try to sustain lending operations with preferred urban clients in the face of falling urban deposits even if it means restricting rural loans. Alternatively, the economic downturn may have caused a more rapid decline in rural loan demand than occurred in urban areas. Another reason could be the decline in government funds available for rural lending. Furthermore, during part of this period, the interest rate paid on government certificates was very high so it is reported that some banks shifted part of their portfolio out of loans into these certificates. A more detailed analysis of lending operations is needed to sort out this issue. On the deposit side, it is clear that compared to urban areas, rural deposits did not grow as quickly in the prosperity of the 1970s nor did they decline as quickly in the recession of the 1980s. (Fig. 3)

The two additional financial deepening measures of loan:GDP and deposit: GDP ratios are presented in Table 11. These data show that the financial deepening that occurred in the early part of the period is a temporary and unsustainable development. The urban loan:GDP ratio generally increased from 1977 to 1983 indicating that over time the urban area utilized a relatively larger amount of loans to generate a unit of economic output. During the same period, the rural loan: GDP ratio hardly changed. The ratio for both sectors declined after 1983 so that by 1986 they were both lower than in 1977. In the case of the rural sector, the

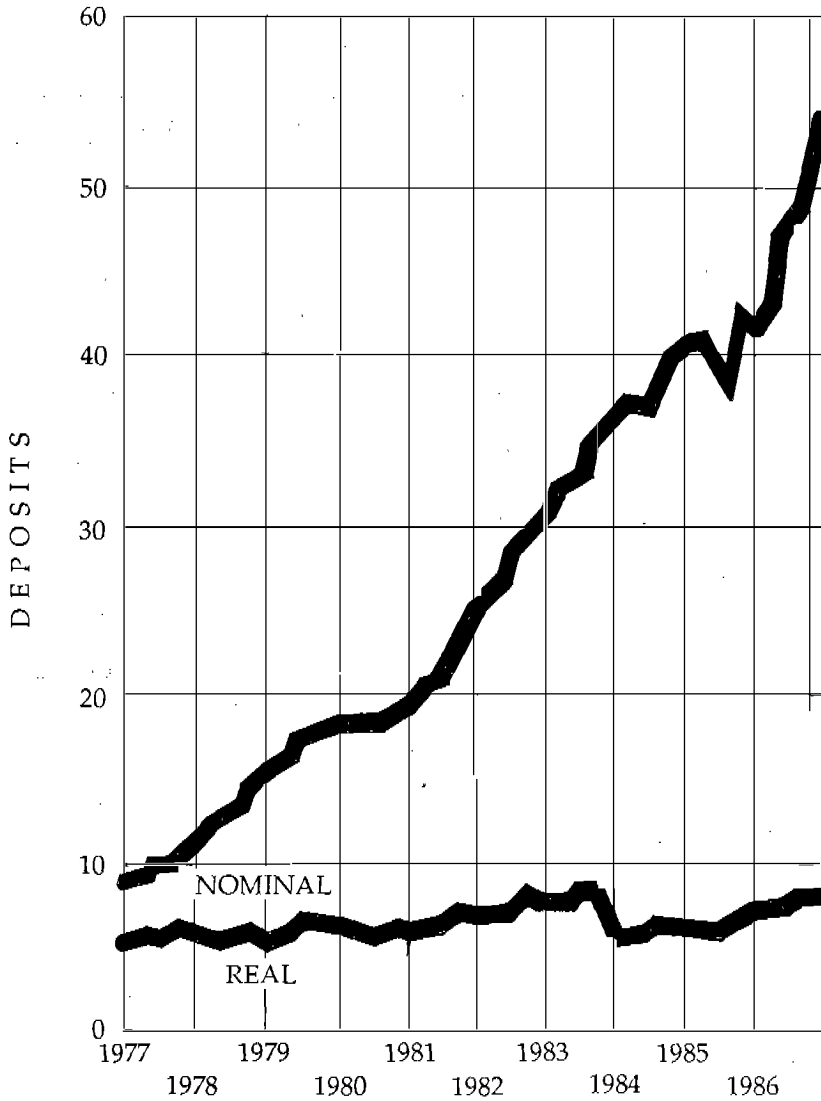
Table 10
GROWTH RATES OF REAL GDP, BANK DEPOSITS AND
LOANS, RURAL vs. URBAN^{a/} 1977-85

ITEM	Period		
	Whole Period (1977-1985)	1st Sub-period (1977-1981)	2nd Sub-period (1981-1985)
	(Percent)		
RURAL			
GDP	2.15	4.96	-1.20
Deposits	3.90	6.63	-4.41
Loans	-2.73	6.49	-19.20
URBAN			
GDP	1.86	5.72	-3.47
Deposits	2.73	12.56	-8.25
Loans	2.74	11.55	-7.24
PHILIPPINES			
GDP	2.07	5.20	-1.90
Deposits	2.98	11.36	-7.43
Loans	1.92	10.67	-8.98

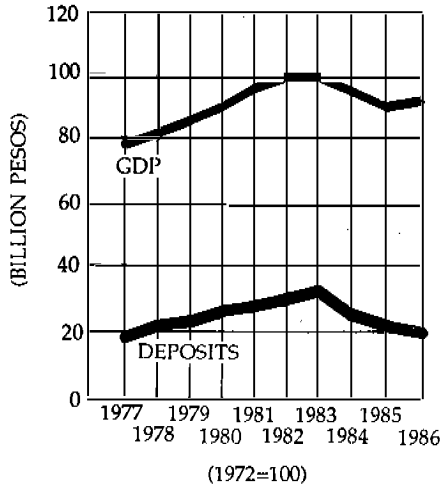
^{a/} Growth rates were estimated using OLS on quarterly financial data deflated by the regional implicit GDP deflator (IPIN).

Sources of basic data: Central Bank of the Philippines, *Factbook Philippine Financial System, Supplement, Regional Profile of Banks*, various years.
 National Economic Development Authority (NEDA), "Philippines Regional Income Accounts," mimeo.

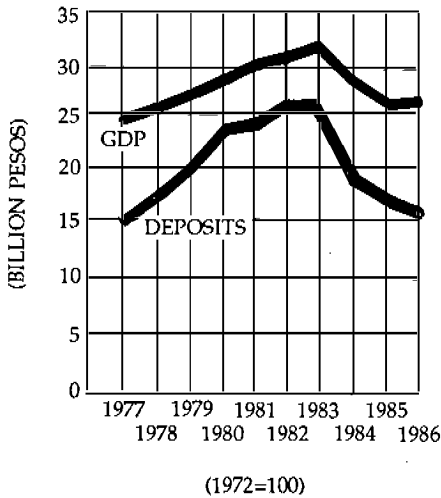
FIG. 2 RURAL DEPOSITS, NOMINAL VS. REAL
 1977-1986 (In 1972 BILLION PESOS)



**FIG. 3 PHIL. REAL GDP AND DEPOSITS
1977-1986**



**NATIONAL CAPITAL
REGION (NCR)**



RURAL AREAS

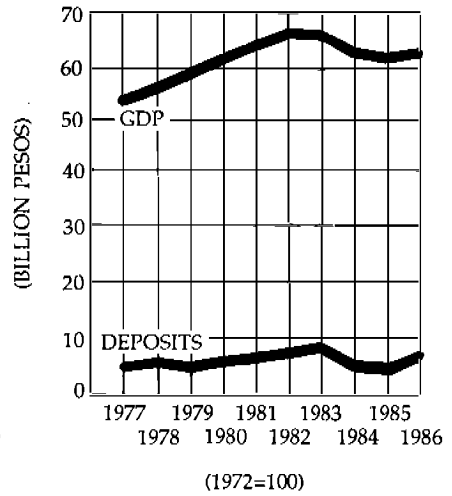


TABLE 11
FINANCIAL DEEPENING INDICATORS,
URBAN vs. RURAL, 1977 - 1986

YEAR	PHIL	URBAN	RURAL
1. Loan: GDP Ratio			
1977	0.36	0.94	0.12
1978	0.39	1.03	0.12
1979	0.42	1.15	0.12
1980	0.44	1.19	0.12
1981	0.44	1.15	0.13
1982	0.45	1.15	0.13
1983	0.49	1.28	0.13
1984	0.40	1.14	0.09
1985	0.31	0.91	0.07
1986	0.30	0.83	0.08
2. Deposit: GDP Ratio			
1977	0.25	0.63	0.08
1978	0.27	0.68	0.09
1979	0.29	0.74	0.08
1980	0.31	0.81	0.08
1981	0.32	0.80	0.09
1982	0.33	0.82	0.11
1983	0.34	0.81	0.12
1984	0.27	0.68	0.08
1985	0.25	0.65	0.09
1986	0.25	0.60	0.11

decline is a remarkable 50 percent (0.12 to 0.08). This implies that self-finance and, most likely, informal finance plays increasingly important roles in financing rural economic activities.

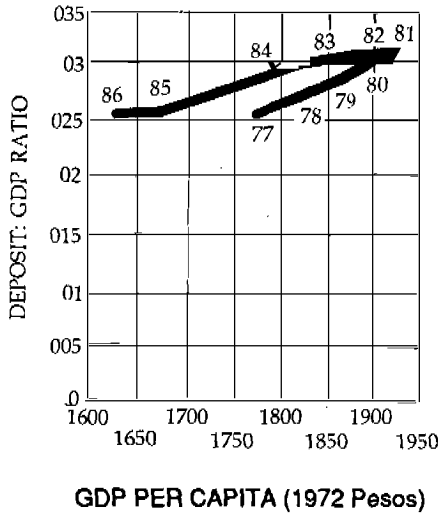
A different picture emerges with deposits. The urban deposit:GDP ratio follows a pattern similar to loans (rising to peak in the early 1980s, then falling so the 1986 level was below 1977). Surprisingly, the rural sector follows a different pattern. There is only a slight increase during the 1970s as deposit growth was roughly similar to GDP growth. Deposits grew more rapidly than GDP during the 1980s, however, so that the ratio ended the period at 0.11 compared to 0.08 at the beginning.

The deposit: GDP ratios are also presented in Figure 4. Although there are significant differences in scale (urban ratios of 0.8 compared to 0.08 for rural areas), the similarities and differences between the two sectors are important to note. In both sectors, as GDP increased deposits rose at a faster pace so the deposit:GDP ratio rose, especially for the urban sector. As real GDP began to fall after 1981, however, deposits did not fall as quickly. The decline in deposit: GDP ratio during the recession was slower than would have been predicted by the path of the increase observed during the expansionary period.

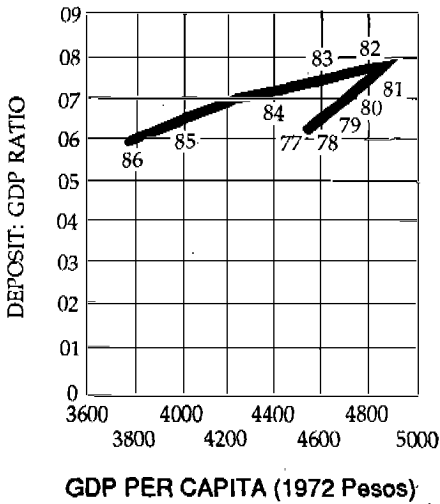
These findings show that during the 1980s rural and urban savers were willing to hold a higher proportion of GDP in deposits at similar or lower levels of GDP per capita than in the 1970s. Surprisingly, the rural deposit: GDP ratio continually rose in the 1980s when GDP per capita fell.

This analysis will have to be extended with more recent data to see if these conclusions hold or simply represent lags in adjusting deposits to falling GNP. If these trends continue, it will be useful to determine why there seems to have been a shift toward higher deposit:GDP ratios relative to GDP per capita during a period of economic stress, political strife and uncertainties about bank safety. Several factors could be at work. First, this result could represent the effect of learning: depositors may have become accustomed to the use of banks during the expansion of the economy and the financial system in the 1970s and chose to keep a larger than predicted level of deposits in the 1980s even though the economy and the banking system network shrank. Secondly, with the tightening of rediscount conditions, banking institutions may have worked harder to mobilize deposits in the 1980s. Third, the improvement in real rates of return on deposits after interest rate deregulation may have stimulated additional deposits, especially during a recessionary period when rates of return on other investments may have been low and uncertain. Fourth, there may have been a shift in demand for deposits because of changes in household income distribution and large amounts of foreign remittances received by rural households.

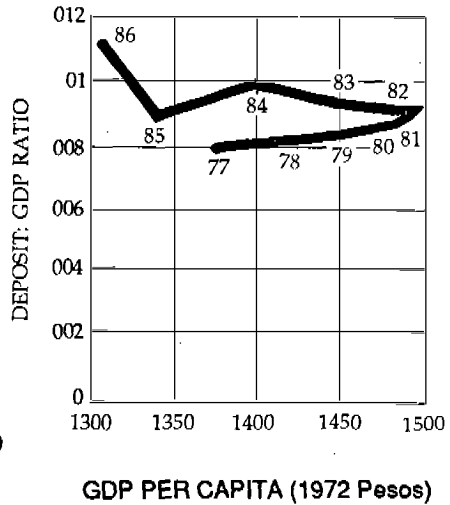
**FIG. 4 DEPOSIT AND INCOME GROWTH TRENDS
PHILIPPINES 1977-1986**



**NATIONAL CAPITAL
REGION (NCR)**



RURAL AREAS



Conclusion

The analysis in this paper shows that there is a large potential financial market to be tapped in rural areas due to its large share of population and GDP. Government efforts to improve rural access to financial services resulted in an expansion of rural banking offices up to 1983 when they exceeded 2600 units, but the number began to decline thereafter. The bank density ratio in rural areas was no greater in 1986 than it was in 1977. Over 40 percent of the rural municipalities still had no banking offices in the mid 1980s. Although rural areas have about 70 percent of the banking offices, they represent less than 20 percent of bank assets and loans. The share of rural deposits increased to about 30 percent in 1986, however, in spite of the decline in rural banking offices.

A comparison of rural and urban areas in growth in GDP, loans and deposits over the 1977-86 period reveals an interesting contrast. Deposits and loans grew faster than GDP in the expansionary period of 1977-1981 for both areas, but the growth rates in the rural areas were only about one-half of what they were in urban areas. Therefore, financial deepening was occurring much more quickly in urban areas. In the recessionary period of 1981 to 1986, deposits and loans fell in both sectors. These declines were roughly parallel in the urban areas so by 1986, the urban loan:GDP ratio and deposit: GDP ratio were roughly equal to or below their 1977 levels. In the rural areas, however, loans fell much faster than deposits so the rural loan: GDP ratio in 1986 was 50 percent less than in 1977, while the deposit: GDP ratio actually rose from 0.08 to 0.11 during the period. The rural deposit: GDP ratio continued to increase in the 1980s despite a decline in rural banking offices and in per capita GDP. Several factors could explain this result such as the increase in the real rate of return earned on deposits, changes in income distribution, the effect of learning the banking habit, and more aggressive deposit mobilization by banks.

There appears to be a considerable opportunity remaining to tap rural deposits. Past emphasis on encouraging rural banking through heavy subsidies and easy access to government funds may have discouraged lending institutions, especially Rural Banks, from aggressively pursuing deposit accounts. The regulated interest rate structure coupled with high inflation may also have been a disincentive. The current contraction in rural banking offices is a disappointing development because of the increase in depositor transaction costs that may occur when accessibility is reduced. Some Rural Banks are now undertaking special campaigns to mobilize new deposit accounts. Their experience may help provide guidance about the crucial elements of a rural deposit mobilization program.

In spite of a long history of government efforts, there is still a considerable urban bias in the financial system. The expansion of rural banking offices suffered a contraction in the past few years. Rural loans and deposits represent a fairly small share of total banking activity in spite of the large size of the sector and its population. It is clear that the Philippines has yet to find the appropriate formula to develop rural financial markets on a viable, self-sustaining basis. Tapping rural deposits should be a fairly simple task of offering attractive deposit instruments, reducing depositor transactions costs, and improving perspectives about the security of banks. The efficient expansion of rural lending requires a better understanding of the risks and returns available from rural investments, and investors' perceptions about such returns. Improving rural investment climate is a much more difficult long-term challenge than simply tinkering with financial and banking policies.

Annex Table 1
PHILIPPINES: STRUCTURAL CHARACTERISTICS,
RURAL vs URBAN^{d/}, 1977-1986

Year	REAL GDP		POPULATION		PER CAPITA GDP ^{c/}			SHARE OF AGRI. TO GDP (%)			SHARE OF INDUSTRY TO GDP (%)		
	Phil ^{a/}	%Rural	Phil ^{b/}	%Rural	Phil	Urban	Rural	Phil	Urban	Rural	Phil	Urban	Rural
1977	78.5	68.9	44.572	88.0	1,760	4,556	1,378	26.5	0.0	38.4	35.6	53.5	27.4
1978	82.8	68.9	45.783	87.9	1,808	4,631	1,418	26.1	0.0	37.9	35.8	53.4	27.8
1979	88.0	68.8	47.031	87.8	1,870	4,774	1,465	25.7	0.0	37.4	36.4	52.5	29.0
1980	92.6	68.5	48.315	87.7	1,917	4,912	1,497	25.6	0.0	37.4	36.1	52.2	28.7
1981	96.2	68.3	49.526	87.6	1,943	4,971	1,514	25.6	0.0	37.5	36.3	52.3	28.9
1982	99.0	68.2	50.741	87.5	1,951	4,975	1,520	25.6	0.0	37.6	36.1	51.9	28.7
1983	99.9	67.7	52.052	87.4	1,920	4,928	1,487	24.9	0.0	36.7	36.0	51.6	28.5
1984	93.9	68.9	53.350	87.4	1,761	4,339	1,388	27.1	0.0	39.3	34.2	51.4	26.5
1985	89.8	70.4	54.668	87.3	1,643	3,833	1,324	29.0	0.0	41.2	32.2	52.0	23.8
1986	90.8	70.3	56.005	87.2	1,621	3,771	1,306						

^{a/} Aggregate for the Philippines is in billion 1972 Pesos.

^{b/} Aggregate for the Philippines is in million inhabitants.

^{c/} All in 1972 Pesos.

^{d/} In this and subsequent tables, "PHIL" and "Philippines" are used interchangeably; "urban" refers to "NCR" or National Capital Region in the NEDA data series, or "Region IV" in the Central Bank data series. "Rural" refers to the rest of the Philippines outside of the NCR (NEDA data series), or outside of Region IV (Central Bank data series).

Sources of basic data:

NEDA. "The Regional Income Accounts of the Philippines, 1972-1983" (mimeo).

_____. "The Regional Income Accounts of the Philippines, 1983-1985," Preliminary Estimates as of June, 1985, (mimeo).

_____. "The Regional Income Accounts of the Philippines, 1984-1986," Preliminary Estimates as of June, 1987, (mimeo).

Annex Table 2
NUMBER OF MUNICIPALITIES, BY NUMBER OF BANKING
OFFICES, URBAN vs. RURAL, 1983 - 1986 ^{a/}

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

^{a/} The reporting of number of towns by number of banking offices began only in 1983.

^{b/} In 1975, there were 1,461 municipalities in the Philippines. Note that for 1983-84, the totals reported are less than the 1975 total, and for 1985-1986 the totals are much greater. For the latter period, much of the increase in the count of municipalities is accounted for by the Frontier Regions, i.e., the Cagayan Valley (Region II) and the Mindanao Regions.

Sources of basic data: Central Bank of the Philippines, *Factbook Philippine Financial System, Supplement, Regional Profile of Banks*, various years.

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