

ASYMMETRIC INFORMATION IN RURAL FINANCIAL MARKETS AND INTERLINKING OF TRANSACTIONS THROUGH THE SELF-HELP GROUPS

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Introduction

The recent international debt crisis and the failure of inward-looking, capital-intensive development strategy of many developing countries to deliver the expected growth in wealth and incomes for the vast majority of their population created a renewed interest in an agriculture and rural-based development approach. The reversal of strategies is anchored on both efficiency and equity grounds. Unlike the earlier view which sees the agricultural sector as a source of investible surplus for industry, the current thinking is that the direct development of the sector is an end in itself, considering the large and growing concentration of impoverished people in the sector.

In the Philippines, this meant the redirection of resources to the rural sector which contributes almost one-third of gross value added, generates 60 percent of export earnings, employs half of the labor force and provides jobs for 70 percent of the population.

Thus, financial reforms, among others, have been introduced in the rural financial markets to create a hospitable economic and financial environment for growth in the rural areas. These financial reforms include the deregulation of interest rates, the consolidation of some twenty separate government credit programs into the Comprehensive Agricultural Loan Fund (CALF), which used to guarantee loans made to the rural borrowers, especially small-scale farmers, fishermen and rural entrepreneurs, the rehabilitation of an ailing rural banking system and the move of the Central Bank away from direct involvement in credit allocation and development finance to the traditional Central Bank function of money supply management and supervision of the financial system.

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One of the issues concerns the rural borrower's access to the financial services of formal financial institutions. Small entrepreneurs, fishermen, and farmers find it difficult to get bank credit and are left with two possible sources of credit: (a) self-finance, and (b) informal lending. In the Philippines, these small borrowers have traditionally relied on informal lenders in view of the limitations of self-finance and lack of access to bank credit. Table 1 provides an idea of the extent of dependence on informal loans in the rural areas of the Philippines. This dominance by the informal lenders often happens in highly segmented capital markets of developing countries where different borrowers face "different effective prices" (McKinnon 1973) for land, labor, commodities and capital.

This paper discusses the small borrowers' lack of access to bank credit and other financial services within the framework of the asymmetry of information that exists in rural financial markets. Asymmetric information drives a deep wedge between the vast number of small rural borrowers and formal financial institutions making loan contracting difficult. The paper shows that the observed phenomenon in the rural areas of interlinking transactions between banks and various rural-based organizations like farmers' associations and self-help groups provides a convenient mechanism to ensure access to bank credit and fiscal discipline among borrowers.

The paper is organized into four sections. The first section discusses how asymmetric information prevents access to bank credit by small rural borrowers. Section 2 is a brief description of the informal credit markets in the rural areas. Section 3 discusses interlinking in the rural financial market as a response to the imperfect information structure. In particular, it describes the phenomenon observed in the rural areas of self-help groups linking with the banks as convenient mechanism to ensure access to bank credits. Section 4 deals with the scope for public policy.

Asymmetric Information in Rural Financial Markets

The transaction in credit markets is not similar to transactions in other markets like the goods market. In the latter type of market, the task and objectives are relatively simpler: sell the good and the transaction is terminated upon receipt of payment. The commodity seller does not worry about who the buyer is or what happens to the commodity after the sale as long as he gets paid.

A loan transaction is much more complicated. A great deal of information both on the personal characteristics of the borrower and the project applied for financing is required. It is crucial for the bank to know the viability of the project, the loan purpose, the creditworthiness of the

Table 1. EXTENT OF BORROWING FROM FORMAL AND INFORMAL SOURCES IN THE PHILIPPINES

Period Covered	Author/Year of Publication or Release	Number of Loans/ Farmer-Borrowers	Credit Source	
			Formal	Informal (Percent)
1954-55	de Guzman (1957)	2,411 loans	12.0	88.0
1957-58	Gapud (1958)	256 loans	10.0	90.0
1957-58	Sacay (1961)	916 loans	13.0	87.0
1960-61	BCS (1963)	1,679,000 loans	7.8	92.2
1967-70	Mangahas (1975)	151 Borrowers	11.9	88.1
1970-71	Mangahas (1975)	297 Borrowers	20.9	79.1
1969-70	Almario (1970)	138 loans	37.7	62.3
1969-70	Balagot (1974)	134 Borrowers	21.6	78.4
1973	DA (1974)	620 loans	51.3	48.7
1973-74	PCARR-Baecon (1974)	3,304 loans	92.2	7.8
1974	Cigaral (1977)	421 Borrowers	94.0	6.0
1975-76	DA			
	Iloilo (Feb 1977)	341 loans	82.7	17.3
	Iloilo (Jan 1977)	703 loans	67.6	32.4
	Zamboanga (Apr 1977)	551 loans	74.6	25.4
1976	DA (1976)	268 farmers	17.2	82.8
1977	UPBRF (1977)	1,079 loans	36.9	63.1
1977	DA (1977)	405 farmers	5.2	94.8
1977	TBAC (1978)	656 Borrowers	25.8	74.2
1978	DA (1978)	338 farmers	3.8	96.2
1978	TBAC (1981)	2,110 loans	17.4	82.6
1979-80	NIA-SGV (1980)	299 farmers	20.0	80.0
1981-82	TBAC (1984)	871,600 loans	40.2	59.8
1986	SWS (1986)	1,200 respondents	33.0	67.0
1986	ACPC (1988) *	1,000 households	16.0	72.0

Data comparability is limited by differences in sampling.

- BCS - Bureau of Census and Statistics
- DA - Department of Agriculture
- PCARR - Philippine Council for Agricultural Resources Research
- BAECON - Bureau of Agricultural Economics
- UPBRF - University of the Philippine Business Research Foundation
- TBAC - Technical Board for Agricultural Credit
- NIA - National Irrigation Administration
- SGV - Sycip, Gorres and Velayo
- SWS - Social Weather Stations
- ACPC - Agricultural Credit Policy Council

* Proportions for formal and informal will not add up to 100%. The remaining 12% borrows from both formal and informal sources.

Source: Agricultural Credit Policy Council.

borrower and his strategic behavior.

A good part of the time is spent in locating a "good" borrower and a "good" project. After the bank has judged the project to be viable and creditworthy, it still has to determine whether it has a "good" borrower. Unlike the commodity seller who does not worry about the character of the buyer, the bank is concerned with the character of the "loan buyer" or borrower. Among other things, the bank worries about what the borrower will do with the loan, how it will be used and whether he will abide by the terms and conditions of the contract (see Clemenz 1986).¹

The bank undertakes to commit financial resources without complete certainty of whether or not the contract will be kept. It also knows that the loan contract is subject to willful default. Borrowers know themselves better than the bank, their own industriousness and moral standards and have "inside information about their own projects (Leland and Pyle 1977). But because borrowers have potentially great gains from understating personal as well as the project's weaknesses and "exaggerating positive qualities" (*ibid*), they can not be expected to fully disclose all relevant personal and project information. The information transfer is thus hampered by serious moral hazards and incentive problems.

Because the profitability of the financial transaction is dependent to a great extent on the probability distribution of borrower default risk, the bank employs screening techniques to insulate itself from default risk. It seeks borrowers with low probability default and small administrative and transaction costs. This drives banks to be conservative with respect to their lending operations and to employ strict sorting techniques.²

The amount and quality of information about the borrower and the project will determine the rejection or acceptance of a loan application. Adverse incentives on the part of borrowers who are inclined to misrepresent their true worth and character are counteracted by the bank's references not only for those with profitable and bankable projects, but also those with proven credit track record and acceptable collaterals.

The bank, therefore, becomes concerned not only with the expected

1. Where there is time lag between receipt of a commodity and payment, as in transaction where the commodity is sold on credit, similar problems may arise. However, as Clemenz (1986) pointed out, more important and interesting problems of this kind are observed in labor markets, insurance and credit markets.

2. Aside from its being a profit center, the bank must also be understood in the light of its obligation to depositors. It is a financial intermediary and therefore seeks out public deposits and acts both as a broker of loanable funds and an asset transformer. At the same time it is a fiduciary institution which must be circumspect with depositors' money. This is another reason for the conservatism of banks. They have to make good account of themselves not only to the shareholders but also to the depositors.

net return from lending but also with variables such as collateral, borrower's equity, cash flows, consumption patterns, other indebtedness, willingness to pay and the personal characteristics of the borrower. The upshot is that the asymmetric information obtaining in credit (especially rural credit) markets drives banks to install elaborate screening systems to help locate a good borrower, a viable project and "sure" income or profits.

The serious information problem in rural financial markets engenders a credit market structure that is complex and very information-dependent. The institutional bias against the small rural borrowers is at the same time formidable and severe. Loan contracting becomes a big problem especially to borrowers who can not send the appropriate signals or indicators of bankability. On the other hand, the significant costs involved in information production and transfer make the banks gunshy.

The rural credit markets are peopled by very heterogenous rural economic agents whose attributes, characteristics and personal circumstances are not entirely acceptable to the bank. On the other hand, the bank and its operations may be totally alien to many of these rural economic agents. From either end, an information gap exists whose size may depend on the particular side, rural borrower or bank, that is considered.

The asymmetric information denies the rural borrower effective access to financial resources and the bank loses the opportunity to intermeditate the rural surplus. The denial of access to financial resources can be illustrated by the following credit transaction matrix (Figure 1).

If both transactors have "perfect" or at least satisfactory information about each other and the project for funding as in cell (A), a loan is contracted. When the information structure for both banks and rural borrowers is inefficient or imperfect, partial contracting, which may include credit rationing results as in cells (B) and (C). The extreme result of cell D is due to a very serious information gap between the two transactors.

Informal Credit Markets in Rural Areas

A significant part of the complex rural financial markets structure is the informal source of credit, the informal lender. The traditional moneylenders are the landlords but lately, a new class of informal lenders composed of traders, input suppliers, big farmers, warehouse owners and spouses of overseas contract workers has emerged.

The majority of rural borrowers in the Philippines have always

FIGURE 1: TRANSACTION MATRIX IN THE CREDIT MARKET

BANK	INFORMATION EFFICIENCY	PERFECT	RURAL BORROWER	
			INFORMATION EFFICIENCY	
		PERFECT	IMPERFECT	
		(A) LOAN IS CONTRACTED	(B) PARTIAL LOAN CONTRACTING	
IMPERFECT	(B) PARTIAL LOAN CONTRACTING	(D) LITTLE OR NO CONTRACTING		

depended on informal lenders for credit. Even at the height of the government-sponsored credit programs like the *Masagana 99*, the great bulk of farmers continued to rely on informal lenders for credit. Sacay *et al.* (1985) report that *Masagana 99* reached as many as 530,000 farmers at one time or roughly one-third of all the rice farmers in the country.

Informal lenders are able to hurdle the information barrier in rural credit markets and maintain low transaction costs which make their lending operations cost-effective. In the first place, the rural borrower and the informal lender literally know each other quite well enabling the latter to form a more accurate probability distribution of the farmer's default risk and factor it into the loan contract. The information wedge can thus be easily eliminated because both transactors operate within the same or familiar socio-cultural and economic milieu. The informal lender has the distinct comparative advantage of knowing his borrower, the specific rural community or economy where the borrower lives and he has at his disposal a reliable (although informal) communication network and a set of informants that help him assess the likelihood of repayment and default.

Furthermore, both transactors are able to produce a loan contract that includes such specific characteristics as flexible repayment schedules, variable amounts of loan amortization, adjustable collateral requirements, payment of the loan at the farm gate and similar features. In effect, the loan contract that is negotiated and finally agreed upon takes into account the specific circumstances of the *locality* and the *rural borrower*.

Another feature of informal credit markets is the ability of transactors to locate and present a substitute to the traditional land collateral which orthodox financial institutions normally require. The collateral substitute makes loan contracting an easier task to accomplish since it helps to close the information gap between borrower and lender by sending signals as to the willingness and capacity of the rural borrower to repay the loan.

The collateral substitute comes in a variety of forms depending on the requirements of the particular informal lender and the characteristics and needs of the borrower. The Agricultural Credit Policy Council 1988 Survey on Informal Credit Markets reveals several collateral substitutes adopted by the informal credit markets. These are: a) *third party guarantees* where the loan is given on the strength of a guarantee provided by a third person, usually somebody with the means to repay the loan if the original borrower defaults; (b) *tied contracts* where the loan is given on the promise or agreement that the lender will be the sole or principal buyer of the produce at mutually acceptable implicit interest rate; (c) *threat of loss of future borrowing opportunities* which for as long as it represents a credible threat is an effective means to keep the integrity of the

loan contract; and (d) *the mortgaging of tenancy or cultivation rights* which affords the mortgagee to derive actual and beneficial use of the land which yields him returns over and above the earnings derived from the principal.

Interlinking in Rural Financial Markets

While there may be valid reasons for the existence of informal lenders such as the financial service they render to clients who are not entertained by the formal financial institution, it can not be denied that informal lending also has its limitations.³ Real financial intermediation is the domain of financial institutions which provide a safe haven for the rural surplus and a source of investible funds for rural entrepreneurs.

The problem with informal finance is its inability to sustain the credit needs of a growing rural economy and to intermediate the rural surplus. The formal financial institutions, on the other hand, are able to accomplish these tasks. The bank is a multi-product firm which provides not only loans and deposit-taking services but also other financial services such as brokerage services, portfolio management and investment counselling. These are products which are clearly beyond the capability of informal lenders to produce or provide. However, they must gear up for business dealing with rural entrepreneurs. From the other end, rural entrepreneurs must look for concrete ways to reduce informational and transaction costs and present themselves as worthy bank clients.

The interlinking of transaction that is commonly observed in rural credit markets provides some insights for developing a systematic and active relationship between the banks and rural borrowers. An interlinked transaction, following Bell (1988), takes place when two parties trade in at least two markets on the condition that the terms of all such trades are jointly determined. A number of studies point to the interlinked transactions as (a) an efficient way to reduce the excessive costs of acquiring information between transactors in imperfect markets (Bardhan 1980; Basu 1984); (b) an efficient economic response to unequally distributed information arising from the uncertainty in agriculture (Mitra 1983); and (c) a significant device to reduce transaction costs since it is some sort of a screening device which prevents borrower default. (Basu 1984).⁴

3. A contrary view is the criticism that informal lenders use their dormant position in the rural sector to exploit the small farmer borrower.

4. Bardhan (1980) and others noted that interlocking transactions, say credit transactions with wage contracts, is also a source of additional monopoly power for the dominant partner in such transactions. See also Gangopadhyay and Sengupta (1987; 1986); Bhaduri (1977).

The costly production and transfer of information between transactors in the rural financial markets may rule out the chance for small rural borrowers to ever get a loan. At the same time, the situation creates incentives to renege on loan contracts when individual calculations show it to be advantageous. In either case, a contracting problem emerges. In the first case, no loan contract may be made in view of the tremendous information gap between transactors. This is case D in Figure 1. In the second case, a repeat transaction and a renewed loan contract may be ruled out when there is effective default on the first transaction.

One example of credit interlinks that is observed in rural Philippines that bears consideration is the attempt to forge linkages between the banks and rural organizations like the self-help groups. Self-help groups are voluntary associations of people at the grassroots level that are formed in order to cope with the difficulties of conducting economic and business activities in the rural economy. The members are held together by a common objective which is to address economic and/or non-economic problems affecting the well-being of the group members.

In the rural financial markets, the self-help groups come in different varieties: rotating savings and credit associations, credit unions, credit cooperatives and farmer's associations organized, owned, operated and controlled by the people themselves. After organizing and establishing themselves as viable groups, some of these organizations try to link up with the banks to develop access to formal financial resources.

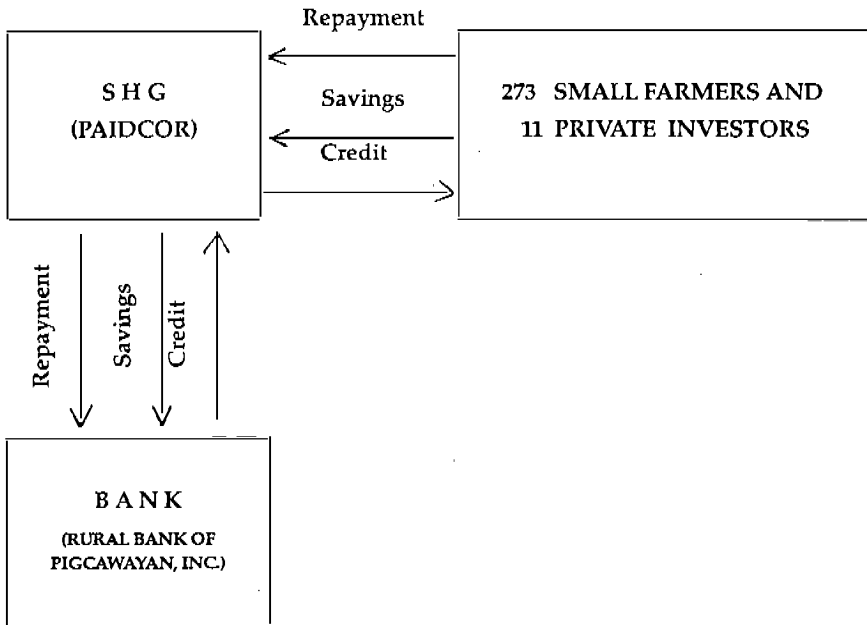
Under the link up concept, an institutional link or tie-up with the banks is developed either through the initiative of the group itself or the bank. The link is not a passive and one-sided deposit-taking relationship on the part of the bank. It appears to be an active and mutually beneficial economic and financial exchange between two parties. There is a vast range of contracting possibilities offered by the link.

In one case study documented by the Agricultural Credit Policy Council (ACPC), a corporation was organized by a rural bank's stockholders and the bank's farmer-borrowers⁵ to (a) screen or filter loan applications, (b) instruct its farmer-members on the rudiments of finance with a strong emphasis on deposit mobilization and loan repayment, and (c) act as collection agent of the bank. This phenomenon bears watching because it seems to offer a workable approach to remove the information barrier in the rural financial markets. Figure 2 illustrates this relationship.

The Pigcawayan Agro-Industrial Corporation (PAIDCOR) is a rural-based corporation organized by (a) 11 private stockholders of the Rural Bank of Pigcawayan in Cotabato, Southern Philippines; (b) 273 farmers

5. E. Morte and G. Llanto. "A Bank-Farmer Approach to Rural Credit: The Case of PAIDCOR, ACPC, 1989. Other cases are discussed in the ACPC Case Studies of SHG-Bank Linkage Schemes in the Philippines.

Figure 2: PAIDCOR LINKING MODEL



borrowers of the rural bank; and (c) the RB Pigcawayan itself. It helps farmers get production loans from the rural bank at the prevailing market rates of interest and at the same time acts as a fund conduit and some sort of a guarantee to farmer loans. Payments are made *in kind* to PAIDCOR which take charge of repaying the bank loans in cash. It markets the farmers' produce and provides them with post-harvest, processing and marketing facilities. It also operates a Farmers Mutual Benefit Fund which consists of the collective savings of the farmer-members of PAIDCOR.

The Fund is the farmer's source of consumption and emergency loans during lean months. Because it is not a mere conduit but a line of first defence against a bad or defective loan, PAIDCOR reduces the information gap and transaction costs inherent in small farm credit. It is a strategic device to keep the rural bank away from bad loans; at the same time it identifies the more creditworthy farmer borrowers. In case of default, PAIDCOR as a corporation of like-minded individuals with a common interest, exerts pressure on its member-borrowers to repay the loan. Otherwise, other members' access to bank credit will be cut. PAIDCOR which is tasked to collect the loan can enforce the loan contract more effectively than the rural bank can do with an ordinary client. The bank does not have enough information and pressure techniques to enforce collection unlike this self-help group which has the appropriate information on its members and can exert enough peer pressure to assure loan recovery from among its members.

Asymmetric Information and the Scope for Public Policy

Information is costly to produce especially in the rural areas. There may be little incentive to a private bank to invest in the production of information in view of the heterogeneity of potential borrowers, the spatial dispersion of agricultural activities which increases risk and uncertainty, the variability of yields, fluctuating terms of trade and the complex character of socio-economic relations in the rural areas. Incomplete information and in many instances, the lack of it, prevents the realization of loan contracts between formal financial intermediaries and numerous rural borrowers. On the other hand, the informal lender's inside information and his low transaction costs give him an edge over banks and he uses this comparative advantage quite extensively as shown by past surveys.

What emerges then is a myriad of contracts between informal lenders and rural borrowers which are designed and adopted to the idio-

syncracies of the locality and the characteristics of the borrower. Some of these conditions involve any of the following:

- a) a tied contract where the borrower is obliged to sell his produce to the trader lender at a price stipulated by the latter;
- b) repayment of principal and interest in kind as in the case of corn farmers in Southern Mindanao, Philippines;
- c) mortgage of cultivation rights to the lender for a specified period of time as observed in Central Luzon, Philippines;
- d) better terms like lower interest rates and longer maturities for tested borrowers' and
- e) terms and conditions suited to the specific geographic location and the borrowers' individual characteristics.

These variegated contracts indicate the ease with which the informal credit markets can adjust to the specific needs of the transactors and its ability to hurdle the informational problem presented by rural lending.

It is very tempting at this point to invoke government intervention in view of the incomplete market structure and the existence of asymmetric information in rural financial markets. The orthodox approach is to create state-owned or controlled banks or similar organizations to provide direct competition to the informal lenders. It is held that state-owned banks should lend to rural borrowers at subsidized rates since private banks especially commercial banks, are not intended to operate in rural financial markets. The competition is supposed to influence informal lenders to bring down their interest charges on rural borrowers and cease from exercising market power.

There is however, no clear-cut case for direct state intervention. Considering the huge information problem, it is doubtful whether state-owned banks can as efficiently produce the same valuable, inside information that informal lenders now possess and whether they can simultaneously keep transaction costs sufficiently low to give them a competitive edge. Furthermore, the element of credit subsidy opens the door for various rent-seeking exercises whether by private agents or government bureaucrats. The case for direct state intervention is also weakened by the worldwide experience that a market-driven economy which relies to a very great extent on private sector initiative and enterprise performs better than one where there is a large public sector involvement. The same experience also shows that a financial system largely dominated by state-owned or controlled banks brings about more distortions and inefficiencies than a market-driven system.

What then is the scope for public policy? Before this is even discussed,

some interesting points need to be considered. Because information generation is costly given the nature of the rural financial markets, private banks may be discouraged to invest in its production, or at the most, will underinvest in its production, leaving a very large number of unsatisfied borrowers.

A bank, especially a commercial bank may simply be overwhelmed by the sheer number of rural borrowers, many of them small farmers without or little collateral, the relative smallness of the loans applied for and the risky nature of agricultural undertakings. It will not take pains to learn or know more intimately these would-be clients given the costs and the uncertainty of appropriation.⁶

On the other hand, certain private parties like the self-help groups do in fact attempt to produce this information in order to create avenues of access to bank credit and services. They internalize the costs of acquiring and generating information and use this to tap bank resources. The only difference, however, is that the expected output may be very group- and location-specific. The self-help groups seem able to solve the information problem although the information produced *by* and *within* the group is very specific to its members and organization. It has valuable, inside information on its members which enables it to sort doubtful borrowers and exert peer pressure to complete compliance to the loan contract and this paves the way for linking up with banks.

The ability to process valuable inside information lead to the creation of a norm of contractual behavior which makes members observe loan contracts. Willful default can lead to peer sanction and even to eviction from the group. Since the group satisfies the needs of the individual member, termination of membership on account of a willful breach of contract is a costly experience to defaulters. Thus, loan contracts are kept and repeat loans are assured.

Credit market interlinking in the manner described here is akin to what Landa (1988) calls the Chinese strategy of "particularizing exchange relations." This is built on mutual trust developed over time and the operation of effective sanctions against deviant behavior. These self-help groups could be operating like "clubs" with the "rules of the game" to enforce contracts. At the core of this group is valuable inside information on its members generated by the group. When the self-help group links up with the banks (in the process cutting the middleman role of informal lenders who themselves borrow from the banks and lend to individual

6. Another reason is that the commercial banks have always had ties with commercial and trading interests and are in fact originally established to service the needs of these interests. They are therefore more comfortable with this type of clientele than the rural folk.

rural borrowers), it employs the information so generated to assure the banks of the integrity of the loan contract and brings to its membership valuable information about the bank, the services it offers, the bank's own "rules of the game" and the whole gamut of banking technology.

The specificity of information and particularistic rules of exchange which determine contractual behaviour within the club are its greatest assets. However, they are also ironically the main limitations of the link-up concept because the relationship that has been described so far between the bank and the self-help group may be specific, particular and applicable only to one self-help group. This means that each self-help group has to develop its own link with the banks and this may be a long, expensive and tedious process for the entire community of self-help groups. It must also be noted that the self-help group would tend to be small in size (i.e., there are a few members) because congestion problems and friction arise once unlimited expansion is allowed. Its small size means that only a few farmers, at best a few hundreds, may constitute an efficient group. If credit interlinking is considered to be a feasible solution to the problem of lack of access to bank resources, it would seem that it is constrained by the tedious process of creating such links. The issues that come to mind concerns its replicability on a large scale and its sustainability in the long term.

What may be the role of the state in this context?

1. There is some scope for the production of information that will primarily be of use to the banks. The government through its departments and various agencies is in constant contact with many indigenous, grassroots and self-help organizations. This close contact yields valuable information about the strengths and weaknesses of these organizations. It can therefore install a system of accreditation whereby the identified self-help groups are conferred some "status" which sends a clear signal to formal financial institutions about the bankability of the group and its members. In effect, what is created is information of a public character whose consumers are private banks and whose producer is the state.
2. A more active role of the state may be the allocation of resources for upgrading the creditworthiness of the individual rural borrowers and the self-help groups through skills training on various aspects of financing, project identification, project management and so forth. In some instances, the lack of funds is not the constraining factor but the incapability of individuals and groups to manage the funds and ensure repayments.

3. Since information is never perfect, there will be attendant risks in any endeavor. A case for a guarantee cover for rural loans may be made in this regard in order to offset *part* of the default risk. The government may want to enter into some risk-sharing schemes whereby it agrees to provide cover for the major part of the default risk. In a way, the guarantee cover may substitute for the hard collaterals often required by the banks. This is the philosophy behind the Philippine government's decision in late 1986 to radically alter the approach to rural lending by scrapping the major credit programs in the agricultural sector and pooling the loanable funds into the Comprehensive Agricultural Loan Fund (CALF) which is then used to guarantee rural-based loans. The CALF does not attempt to provide full or 100 percent guarantee cover because such only raises serious moral hazard and incentive problems on the part of the banks. Instead, risks are shared, albeit the major portion of it lies with the government. Table 2 presents the performance of the CALF in the past two years since its inception.

The Comprehensive Agricultural Loan Fund (CALF) is essentially a guarantee scheme that covers up to 85 percent of the default risk of agricultural loans given by the banks. The farmer borrows from the bank and if he qualifies for a loan, he can get a guarantee cover from the CALF after payment of a premium. The bank shares part of the default risk (15 percent) not borne by CALF. Table 2 indicates the loan amounts covered (\$12.7 million) as of June 30, 1989 and the number of individual farmers covered by the guarantee. It also shows the guarantee payments made by the CALF to the banks (\$66 thousand) on account of defaults by 892 farmer-borrowers. The major causes for loan default are typhoons, drought and pest infestation.

The CALF is expected to work as a tool to improve the creditworthiness of the farmer and strengthen the banking system. The recent records indicate that only 6.2 percent of farmer-borrowers out of 14,400 borrowers defaulted but for valid reasons. This guarantee scheme encouraged the banks to lend to small farmers who turned out to be good bank clients.

Table 2. CALF GUARANTEE COVERAGE AND GUARANTEE PAYMENTS

Loan Amount	Number of Borrowers Reached	Guarantee Payment 2/	Number of Defaulters
(Thousand US\$)		(Thousand US\$)	
12702	14400	66.5	892

1/ June 30, 1989

2/ August 9, 1989. Causes of loan default are drought, typhoon, pest infestation.

Source: Agricultural Credit Policy Council

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