



ACPC Monitor

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ACPC'S POSITION ON THE PROPOSAL TO ESTABLISH FARMERS' TRUST SYSTEM

Introduction

In its continuing effort to address the failure of the agriculture sector in attracting private investments, the government proposes to adopt a Farmer Trust System, which aims to provide a market-driven institutional mechanism that will bring together farmer groups, private enterprises and agri-based companies for the purpose of consolidating a raw material production base and post-harvest and processing facilities under one integrated business unit in the form of a Trust Enterprise.

The Enterprise, which will be principally owned by farmer-workers, intends to make investments viable, enable the adoption of modern technologies and best farming methods to bring productivity and costs to global standards, and ultimately serves as a vehicle that will empower farmers to join the mainstream economy.

A Service Consortium will be chosen by the farmers on land rights holders to undertake the organization, development and implementation of the Enterprise and assist in securing capital resources through project securitization. The Consortium is proposed to provide a total package of inputs and services including training and technology transfer to the farmers for their eventual takeover of management and technical functions.

To further encourage private entrepreneurs to develop, fund and manage the farmer-owned project trust enterprises, the Quedan and Rural Credit Guarantee Corporation's (Quedancor) *Guaranty Mechanism for Agriculture*, as mandated by its Charter RA 7393 and the Agriculture and Fisheries Modernization Act, is also proposed to provide credit, investment and serve as the guarantee arm of agriculture to the small farmer, producer, upland grower, and fisherfolk.

What follows are ACPC's comments to this proposal:

On the Main Strategy to be pursued under the Proposed System

While the proposal may have some valid points, it nevertheless suffers from some basic flaws. Foremost of these is its focus on the premise that the "smallness of farm production units" is the main reason why agriculture fails to attract investments. Hence, the main thrust of the proposal is to pool land resources so that "investors' interests will be protected."

The fact however, is that other, if not more important, factors also influence the profitability of agriculture and other rural-based projects. Among other things, these include government's inadequate provision of such fundamental public goods as farm-to-market roads (which provide access to markets), irrigation systems (which increase productivity and lessen the unpredictability of agricultural yield), economically sound and consistent policy and regulatory frameworks that would provide guidance as well as protection to stakeholders in the sector, and even the simple maintenance of peace and order.

Moreover, to the extent that the proposal clearly attributes greater significance to the role of financing in improving the profitability of farmers, it commits the perennial mistake of believing that finance is both the cause and solution to agriculture's problem. Indeed, as ACPC has proclaimed time and again, credit/financing cannot make an unprofitable project profitable.

In other words, the consolidation of land alone will not result in the viability of agriculture-based businesses. On the contrary, adopting a small unviable business/project into larger scale will only increase the magnitude of potential losses.

On the Service Consortium

The role of the Service Consortium in providing a “total package of production inputs and services” will require considerable resources. In fact, it might require no less than the combined amount of the Department of Agriculture (DA) and the Department of Agrarian Reform (DAR) budgets, given that the services that the Consortium intends to deliver are basically the services already being provided by both DA and DAR. The resources that will be required therefore logically implies the following:

- No single “Consortium” could take on the role of input and service provider to the entire agricultural sector;
- Even assuming that the proposed System would serve as sufficient incentive for local investors to be enticed to start pouring in more resources to agriculture, a Consortium of local investors alone will still not be able to put up the necessary funding;
- Hence, attracting the participation of foreign investors in the Consortium/s would be the primary strategy and concern;
- In which case, what would still matter the most is the cost profile of local production vis-à-vis the cost profile of our neighbor-competitors. In other words, the bottomline would still be the same, i.e., whether or not the cost of production in the Philippines is relatively cheaper. As mentioned earlier, the issue of viability cannot be addressed by simply consolidating lands.

Meanwhile, to the extent that a Consortium will have sole rights in providing inputs and services, it will also have monopoly control over the pricing of these inputs and services. This suggests that the proposed system – contrary to what the document says – does not truly espouse a market-led or competition-driven business environment, which is also crucial in bringing down production costs. Indeed, in an extreme case scenario, the Consortium’s control over pricing might even be used by its investors and management to justify a declaration of a lower net income for the Consortium and, hence, lower income shares for the farmers themselves.

Also given the similarity between the inputs & services being delivered by the DA & DAR and the inputs & services proposed to be delivered by the Consortium, the proposal should be clearer on the distinction between government’s and the Consortium’s roles in this singular function. Otherwise, the role of the Consortium would be superfluous with, say, that of the DA’s, particularly as provided for under RA 8435 (AFMA).

On the Guarantee Mechanism

The second major feature of the proposal that aims to serve as incentive for attracting investors is the guarantee of “Project Participation Certificates” issued by the Farmers’

Trust. It is further proposed that Quedancor will provide the guarantee cover. This guarantee concept raises the following issues:

- An estimation of credit demand by: (a) projecting annual costs and returns of production, (b) computing cost and returns ratios, (c) projecting annual Gross Value Added (GVA), (d) computing annual production costs (done by multiplying the costs and returns ratios by the annual GVA) and (e) the computation of total credit requirement using the cash costs of production indicates that the total funding requirement for agricultural credit guarantee in FY 2002 is around P26 Billion, while the guarantee fund requirement in FY 2003 is around P28 Billion (see Table1). This means that even government’s combined resources for agricultural guarantee, not to mention Quedancor’s total resources (P2.5 Billion as of FY 2000), are insufficient to meet the total expected guarantee requirements as envisioned by the proposal. In other words, it makes no sense that the proposal aspires to be able to provide guarantee cover to the entire sector, even assuming that all of government’s existing agricultural guarantee resources are poured into such a guarantee facility.

Table 1
Projected Agricultural Credit and Guarantee Requirement
(2001-2003)

Year	Credit Requirements (PM)	Amount to be Financed by Borrowings ^a (PM)	Guarantee Requirement ^b (PM)
2001	116,803	70,082	23,361
2002	128,729	77,237	25,746
2003	142,029	85,217	28,406

a– Based on the 60% proportion of borrowing farmers (ACPC, 2001).

b– Assuming 7:1 leveraging ratio as recommended by the AFMA-mandated report on the Review Consolidation and Rationalization of all Existing Guarantee Programs for Agriculture and Fisheries, i.e., P7 of loans generated per P1 of government guarantee fund (PSR Consulting, Inc., 2000).

- Besides, even assuming that such a huge amount of funds is available, any wise investor knows that pouring these into a firm has to be on the basis of the firm’s proven capacity or ability to absorb/manage the funds efficiently (or profitably). This rule all the more should not be lost in the case of investing or managing public funds or funds that are sourced from government revenues. Unlike private funds, public funds have a social cost, i.e., the economy loses an estimated P2.5 pesos for every one peso of tax revenue (Solon, 1997). Needless to say, there is greater need to generate social benefits – and not losses – where public funds are concerned. In this regard, it would therefore be instructive to first look at how Quedancor has performed as a financial institution.

Table 2 shows that 80 percent of Quedancor's expenses over 1992-98 arises from its guarantee activities. In fact, even with subsidy drawn from investment income, Quedancor's guarantee operation is losing an average of P37 million yearly. Because of this, Quedancor's lending operations subsidizes its guarantee operations. In this regard, however, two things must be pointed out: (a) Quedancor's lending operations generated profit margins (before operating expenses) mainly because it was able to get lending funds at subsidized cost; and (b) the cross-subsidy scheme contributes in the impairment of Quedancor's capital.

Table 2
Profitability of Quedancor's Lending
vs. its Guarantee Operations

	1992	1993	1994	1995	1996	1997	1998
Guarantee							
Guarantee fees	10.5	12.8	20.5	22.6	23.4	22.9	12.6
Investment income	7.6	20.2	27.1	14.6	15.3	26.9	62.1
Operating Expenses	50.3	48.7	63.3	67.4	81.1	112.6	132.9
Contribution to Income	-32.2	-15.7	-15.7	-30.3	-42.4	-62.8	-58.2
Lending							
Int. & other income	26	21.9	27.2	44.7	50.5	88	60.9
Investment income	1.9	5.1	6.8	3.6	3.8	6.7	15.5
Operating expenses	12.6	12.2	15.8	16.9	20.3	28.1	33.2
Contribution to Income	15.3	14.8	18.2	31.5	34	66.6	43.2

Source: Review of the Charters and Performance of LBP, PCIC, GFSME, ACPC and Quedancor.

Table 3 shows the breakdown of Quedancor's reported capital over 1992-98. More than half its capital is actually comprised of non-performing assets (NPAs). However, what is actually available to Quedancor is only the unimpaired capital. Yet, even putting the entire amount of its unimpaired capital in financial investments would generate insufficient income to pay for Quedancor's personnel cost and maintenance and other operating expenses (MOOE).

Table 3
Quedancor Non-performing Assets (NPA)
Impaired vs. Unimpaired Capital
(In Million Pesos)

	1992	1993	1994	1995	1996	1997	1998
Reported capital	302.9	403.7	460.7	513.2	575.2	616.0	670.0
NPAs	128.7	134.8	134.9	151.1	260.6	348.5	395.8
Unimpaired capital	174.3	268.9	325.7	362.1	314.6	267.4	274.2

Source: Review of the Charters and Performance of LBP, PCIC, GFSME, ACPC and Quedancor

Indeed, in a report prepared by a multi-sectoral Study Team formed in 1999 – through the initiative of the DA – to develop innovative financing schemes, the lack of credibility of Quedancor's guarantee programs is identified as one reason why the private sector does not really consider credit guarantee as an attractive incentive mechanism. The Team further established that the lack of credibility stems mainly from Quedancor's record of inability to satisfactorily serve guarantee claims, i.e., claim payments are often late and, sometimes are not paid at all (see Table 4).

Table 4
Status of Quedancor Guarantee Claims
As of June 30, 1999 and 2000

	1999	2000
Guarantee Claims		
No. of FIs with claims	13	50
Amount (P million)	61.1	94.9
Claims approved for payment		
No. of FIs with claims	25	14
Amount (P million)	31.6	23.9
Claims paid		
No. of FIs with claims	21	14
Amount (P million)	43.2	12.6
% Paid to Total Claims Approved for payment	137% a/	52%
Recoveries (P million)	0.141	6.0
Recovery Rate (%)	0.33	48

Source: ACPC Monitoring Reports

- It is therefore curious given the above circumstances, why Section 5.5 of the proposal suggests that Quedancor need not match "amounts contributed to the fund." On the other hand, requiring Quedancor to put up counterpart funding is one measure of ensuring that the amount of funds that will be infused into Quedancor would only be what it can truly absorb.
- Also, we believe the proposal's provision that the "funds generated (for the FTGF) shall remain private in nature" cannot apply to all the funds that might be generated since these will also apparently involve government funds. Lumping government-sourced funds together with private funds is certainly illegal.
- Further, it must be emphasized that the proposed guarantee facility should already form part of the AFMA-mandated Agriculture and Fisheries Credit Guarantee Fund (AFCGF). Otherwise, the creation of a separate guarantee fund/program will be inconsistent with the law. Hence, the guidelines of the AFCGF, as approved by the DA Secretary should be adopted in

implementing the guarantee facility being proposed in the draft EO. Among others, therefore, the leveraging rate on the guarantee fund should be between 6 to 8 times only (as had already been approved) and not “on a one to twenty times basis” as indicated in Section 5.5 of the proposal.

- Finally, in the event that an FTGF will be created, we suggest that the Executive Director of the Agricultural Credit Policy Council (ACPC) also be included among the proposed members of the Board. The presence of ACPC will be instrumental in ensuring consistency between the Board’s policies and government’s overall policies on agriculture credit and financing, especially since one of the proposed functions of the Board is to undertake the planning and policy functions of the System.

On the President’s Role as Head of the Farmers’ Trust System

Again, this seems to contradict the proposition in the draft EO that the “System” is market-driven, because why would government, through no less than the President herself, be the “head” of the System (i.e., provide leadership, planning, organizing and policy functions for the program)? This establishes, in no uncertain terms, that government will again have great leeway and opportunity to intervene in market transactions under the System. The question with this is whether such a set up would truly encourage the participation of private investors, who are historically averse not only to the instability of government’s position and policies, but to being involved in programs/projects that have political intonation as well. Meanwhile, this provision will also have the effect of giving the President undue pressure and exposing her to any controversy that might arise in the event the System encounters some issues/obstacles. Besides, as head of government it is already a given that she is de facto overseer of all government projects and programs.

Concluding Remarks

Overall, the proposed Farmers Trust Enterprise System provokes a lot of issues rather than answers given its many gray areas. The System also clearly intends to provide government with a totally new policy and program framework for agricultural development. How, then, does this impact or reconcile with AFMA, which is government’s/DA’s current rural modernization and development blueprint? Through the establishment of Special Agriculture and Fisheries Development Zones (SFDZs), AFMA also aims to attract private investments in agriculture by establishing marketing linkages that would increase the viability of the projects of small farmers. Likewise, how would the proposed System impact on the Agrarian Reform Program of DAR?

Further, there is also a danger in the proposed System’s similarity with government’s intention when it set up the Coco Levy Funds. Taxes were collected from farmers and were pooled into one fund, supposedly to be used for the benefit of the farmers themselves. After more than twenty years, however, a few “investors” benefited, but the farmers themselves still have to benefit from the funds. Moreover, government’s credibility to the farmers was seriously damaged, resulting in unrest in the farmer sector. Meanwhile, the overall economy continues to suffer as a consequence of the political uncertainty caused by this issue.

Therefore, given the AFMA’s more market-led and comprehensive approach to agricultural modernization & development (as embodied, among others, in the principles of the Agro-Industry Modernization Credit & Financing Program or AMCFP and the setting up of SAFDZs) and its already more advanced state of implementation, we recommend instead that government continue to focus on the AFMA and in getting it fully implemented. Besides, adopting a new direction at a point when an already-existing plan is in mid-implementation would only cause further confusion in the sector, contribute to more uncertainty, and only be counterproductive.

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