

THE AGRI-AGRA LAW (PD717): A Review of Its Performance

PD 717 or the Agri-Agra law was created through a Presidential Decree in 1975 that aimed to enhance the flow of credit to agriculture. It mandates all banks to set aside 25% of their loanable funds for agricultural credit, 10% for the beneficiaries of agrarian reform and 15% for agricultural credits. The law defines agricultural credit as production or other types of loans for acquisition of work animals, farm equipment and machinery, seeds, fertilizers, poultry, livestock, feeds and other similar items; acquisition of land authorized under the Agrarian Reform Code of the Philippines and its amendments; construction and/or acquisition of facilities for production, processing, storage and marketing; and, effective merchandising of agricultural commodities stored and/or processed by facilities aforementioned in domestic and foreign commerce.

Over the years, Congress and the Bangko Sentral ng Pilipinas (BSP) have expanded the means of compliance with the law to include such alternatives as (a) development loans to finance educational institutions, hospitals, socialized housing, and LGUs; (b) investment in commercial papers issued by firms engaged in agri production, processing, storage, marketing, export of agri products; investment in Emergency Readiness Assurance Program (ERAP), Local Government Unit (LGU), Agrarian reform and Pag-Ibig bonds; (c) loans to high value commercial crops (HVCC) projects; and (d) investment in Quedancor capital stocks.

Critics of PD 717, however, argue that the law has so far failed to guarantee improved credit access for farmers. Because agricultural financing generally remains more risky than non-agricultural lending, it is believed that the decree leaves banks with little flexibility in making optimal lending portfolio decisions. This forces them to pass on the cost arising from higher credit risk back to the agriculture borrowers

through higher interest rates. And in the case of the even riskier 10% sub-quota for agrarian reform borrowers, it is suspected that the tendency is for banks to comply more through the alternative option of investing in government securities.

To allow the reader to have an objective insight on how the law has delivered, this paper provides a factual review of the performance of PD 717 over the period 1975 to 2002.

The presentation is divided into two periods: 1975 to 1987, characterizing the martial law years up to a year after the EDSA revolution; and 1993 to 2000. The gap (1988-1992) was the period when the Bangko Sentral ng Pilipinas (BSP) decided to relax the rules on the Agri-Agra law. The data for those years are not available. It is important to highlight this gap to understand why there was a sudden change in the performance of the first observable year following the end of this gap.

Loanable Funds

Over the period 1975-1987, the highest amount of loanable funds generated between 1975 to 1987 was PhP 98 B generated in 1982 (Table 1 and Figure 1). This was also the period when banks exceeded their agri-agra quota. The good compliance rate of the banks during this period could be attributed to the widespread implementation of government subsidized credit programs from the early 70's to the early 80's during which banks especially rural banks served as conduits of these programs. It was during this period when banks had access to cheap rediscounting from the government. This kind of performance by PD 717 was sustained for only two years more after the change in administration in 1986.

Figure 1
Loanable Funds vs. 25% Minimum Credit Requirement

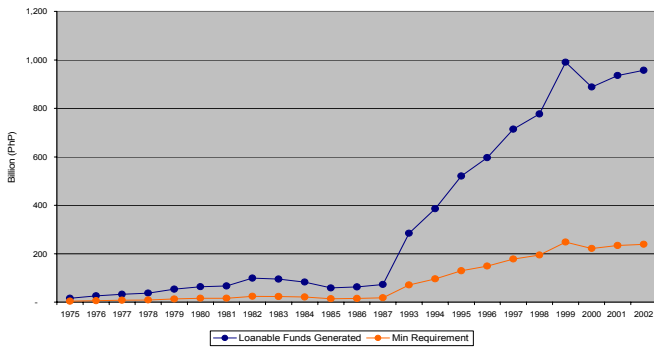


Figure 2C
25% Agri-Agra Credit Allocation: Banks' Compliance vs. Minimum Requirement

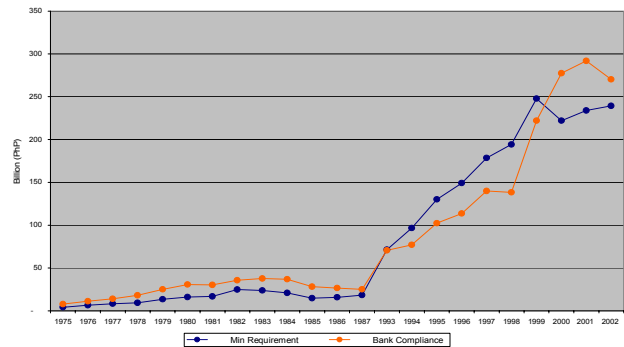


Figure 2A
10% Agrarian Reform Credit: Banks' Compliance vs. Minimum Requirement

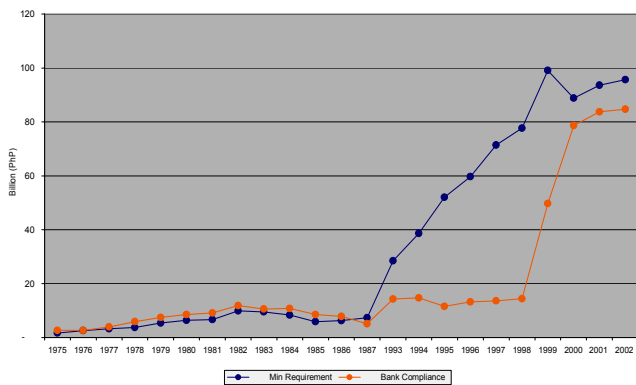
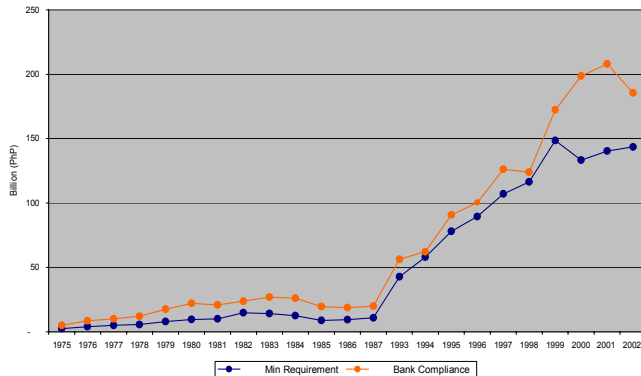


Figure 2B
15% Agricultural Credit: Banks' Compliance vs. Minimum Requirement



Financial reforms introduced in the 80s led to a mandatory increase in bank capitalization. This automatically increased the net amount of funds generated by banks, and, corollarily, the amount mandated to be set aside for agriculture and agrarian reform credit (Ravalo, 1999). By 1993 (i.e., 5 years after the BSP again resumed monitoring the compliance of PD 717), the amount of loanable funds generated by the banking sector had dramatically increased to PHP 285 B. Following the historical average growth rate of 16% over the preceding twelve years, the projected amount of loanable funds for 1993 was supposed to be only around PhP 178 B, i.e., about PhP 100 B smaller than the actual loanable funds generated for the year, suggesting a sustained positive growth in the financial system. From thereon, loanable funds grew steadily, reaching a peak of PHP 990 B in 1999. As of June 2002, loanable funds generated had reached PhP 957 B.

Compliance vs. Minimum Requirement

Comparative figures of banks' compliance against the law's minimum agri-agra loan quota requirement are shown in Table 1, Figures 2A, 2B and 2C. Note again that the banks were able to comply more than what was required by the law over that period 1975-1986. Beginning 1987, there was a change in direction of the trend. This change in the trend has persisted up to the present (2002). As mentioned earlier, the good performance over the first period can be attributed to the banks' access to cheap loanable funds from the government for lending under the latter's subsidized credit programs which were predominant from the 70s to the early 80s.

Alternative Compliance vs. Intended Compliance

The last row of Table 1 shows that more than fifty percent (58% min., 68% max) of the total amount of agra compliance was done through the purchase of treasury bills and other securities. This only shows that banks prefer bonds and other form of securities as means for compliance with the law instead of extending direct loans to the agrarian reform beneficiaries.

A year before the relaxation of the BSP rules on the Agri-Agra law (1987), banks already revealed their clear bias against agrarian reform credit. For the first time, banks fell short of meeting their 10% mandatory requirement (Table 1, Figure 2A and Figure 2D). This was also the beginning of the trend that has persisted up to now in spite of the introduction of other forms of alternative compliance¹ by the BSP in 1999. Based on studies done by ACPC and other analysts, the main reasons for this bias are the following:

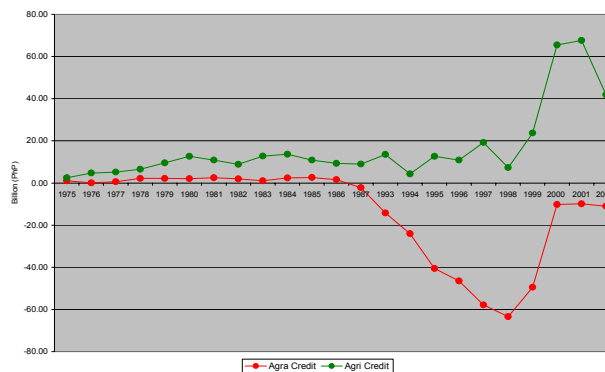
1. The lending risks are relatively higher – Except for the Land Bank of the Philippines (LBP), practically all banks lack familiarity with the agra clients;

2. Low value of collateral – Borrowers principally rely on their farmland as loan collateral. However, some flawed provisions in the Comprehensive Agrarian Reform Law (CARL) have effectively distorted the land market by “outlawing” the market of agricultural land, i.e., by prohibiting the sale, transfer or conveyance of the transferred land for 10 years. Legal land transactions are, in fact, even prohibited beyond 10 years if the land is not yet fully repaid by the beneficiary (Fabella, 2003). A bank survey conducted by ACPC in 1983 revealed that these legal constraints have eroded the exchange value of farmlands and, therefore, make them unattractive to banks as loan collateral; on the other hand, banks are more amenable to accepting chattel mortgage on movable goods or standing crops from agrarian reform beneficiaries (Llanto and Dingcong, 1994). However, given the very limited farm size being managed by each ARB, the value of such chattel mortgage is often barely adequate to cover for the amount being borrowed;

3. Profitability is low – Due to (a) small average size of farmland operated by agrarian reform beneficiaries and, therefore, a weak earning power; (b) seasonal idleness in agricultural capital; (c) drastic drops in production volume often experienced due to natural factors (e.g. typhoons); and (d) in some cases, a long gestation period required for the recovery of capital invested in the familiar projects (e.g. planting of fruit trees, animal breeding and the like).

4. The demand for funds is fragmented in nature – The Agrarian Reform Program brought about a significant shift in resource-ownership – from vast areas of land being held by a few owners, to many small landholdings under numerous owners. For the lender, one of the results of this shift in land ownership structure is a comparative increase in the number of credit transactions and hence, an increase in transaction costs (Casuga, 1993). Economies of scale naturally dictate that banks prefer to process few large loans rather than numerous small loans because of the lesser transactions costs entailed (Huppi and Feder, 1989).

Figure 2D
Banks' Excess/Deficiency of Credit Quota



Conclusion and Recommendation

Because lending to agriculture, especially agrarian reform beneficiaries, remains unattractive compared to other sectors due to the high credit risk involved, banks still have difficulty complying with PD 717 in spite of the existing alternative forms of compliance (e.g., investment in bonds and other securities rather than direct lending to agricultural enterprises). Since the beneficiaries of the agrarian sub-quota in particular are the small farmers, this group of beneficiaries continues to be deprived of easy access to credit.

¹ Includes investments in bonds (ERAP, LGU, Pag-Ibig); Quedancor equity/investment bonds; investments in HVC projects; development loan incentives, low-cost housing; other government securities (MOR, Sec X341.3); and special purpose treasury bonds for CARP (Cr. 301).

PD 717 therefore, needs to be amended to correct its flaws. A recent initiative aimed at amending PD 717 is House Bill No. 1930 (substituting House Bill Nos. 104, 658 and 2166). A main feature of the mentioned legislative bills is the provision this time of *incentives* for banks to lend to the agriculture and agrarian sectors. Among the incentives being considered are (a) the reduction of the gross receipts tax (GRT) rates on interests, commissions and discounts from loans, credit lines and similar credit accommodations extended by financial institutions to small farmers; and (b) the imputation of higher compliance rates to the mandatory loan

quota if loans, credit lines and similar credit accommodations are made directly to agrarian reform beneficiaries and/or eligible agricultural activities, to LGUs specifically for rural development, and to projects with maturity of five years and beyond for the provision, maintenance and upgrade of a component of the rural support system (please see Table 2).

Once these incentives are approved, the banking sector might become more willing to form partnerships with informal lenders or adopt other innovative strategies to expand their Agri-Agra credit outreach.

❖ Tables 1 & 2 are attached.

Table 1. Banks' Compliance with the Agri-Agra Law (PD 717)
(In Billion PhP)

ITEM	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
LOANABLE FUNDS GENERATED (B PhP)	16.29	25.86	32.73	37.17	53.33	63.50	66.77	98.97	94.75	83.10	58.63	62.77	72.94
Minimum Requirement (B PhP)													
10% Agrarian Reform Credit	1.63	2.59	3.27	3.72	5.33	6.35	6.68	9.90	9.48	8.31	5.86	6.28	7.29
15% Agricultural Credit	2.44	3.88	4.91	5.57	8.00	9.53	10.02	14.85	14.21	12.47	8.79	9.42	10.94
25% Total	4.07	6.46	8.18	9.29	13.33	15.88	16.69	24.74	23.69	20.78	14.66	15.69	18.24
Total Compliance¹ (B PhP)													
10% Agrarian Reform Credit	2.67	2.61	3.94	5.91	7.48	8.47	9.14	11.80	10.52	10.73	8.47	7.85	5.07
Direct Loans	0.45	0.86	1.48	2.61	3.87	3.83	4.15	5.63	5.42	5.67	3.66	4.93	4.54
% of Total	16.85	33.00	37.47	44.15	51.78	45.22	45.42	47.75	51.51	52.85	43.15	62.85	89.51
Govt. Securities	2.22	1.75	2.46	3.30	3.01	4.64	4.99	6.17	5.01	5.06	4.82	2.92	0.53
% of Total	83.15	67.00	62.53	55.85	40.20	54.78	54.58	52.25	47.64	47.14	56.85	37.15	10.49
15% Agricultural Credit	4.94	8.58	10.09	12.10	17.52	22.22	20.90	23.70	26.97	26.14	19.63	18.75	19.93
25% Total	7.61	11.19	14.03	18.01	25.00	30.68	30.04	35.50	37.49	36.87	28.10	26.60	25.00
Alternative Compliance² (B PhP)													
10% Agrarian Reform Credit													
15% Agricultural Credit													
25% Total													
Excess/(Deficiency) (B PhP)													
10% Agrarian Reform Credit	1.04	0.03	0.66	2.19	2.14	2.11	2.47	1.90	1.05	2.42	2.61	1.57	(2.22)
15% Agricultural Credit	2.50	4.70	5.18	6.53	9.52	12.69	10.89	8.85	12.76	13.67	10.83	9.34	8.99
25% Total	3.54	4.73	5.85	8.72	11.67	14.80	13.35	10.76	13.80	16.09	13.44	10.91	6.76
Compliance Ratio³ (%)													
10% Agrarian Reform Credit	16	10	12	16	14	13	14	12	11	13	14	13	7
15% Agricultural Credit	30	33	31	33	33	35	31	24	28	31	33	30	27
25% Total	47	43	43	48	47	48	45	36	40	44	48	42	34

ITEM	1993	1994	1995	1996	1997	1998	1999	2000	2001*	2002 e/
LOANABLE FUNDS GENERATED (B PhP)	285.01	386.26	520.43	596.55	714.21	776.97	990.63	888.42	935.71	956.81
Minimum Requirement (B PhP)										
10% Agrarian Reform Credit	28.50	38.63	52.04	59.66	71.42	77.70	99.06	88.84	93.57	95.68
15% Agricultural Credit	42.75	57.94	78.06	89.48	107.13	116.55	148.59	133.26	140.36	143.52
25% Total	71.25	96.56	130.11	149.14	178.55	194.24	247.66	222.11	233.93	239.20
Total Compliance ¹ (B PhP)										
10% Agrarian Reform Credit	14.24	14.63	11.53	13.21	13.56	14.36	49.66	78.62	83.75	84.68
Direct Loans	c	c	c	c	c	c	c	c	c	c
% of Total	c	c	c	c	c	c	c	c	c	c
Govt. Securities	c	c	c	c	c	c	c	c	c	c
% of Total	c	c	c	c	c	c	c	c	c	c
15% Agricultural Credit	56.29	62.28	90.70	100.34	126.35	123.90	172.27	198.75	208.03	185.43
25% Total	70.54	76.91	102.24	113.55	139.91	138.25	221.93	277.37	291.77	270.11
Alternative Compliance ² (B PhP)										
10% Agrarian Reform Credit							31.90	45.20	57.25	56.60
15% Agricultural Credit							13.78	16.03	24.56	24.87
25% Total							45.68	61.23	81.82	81.47
Excess/(Deficiency) (B PhP)										
10% Agrarian Reform Credit	(14.26)	(23.99)	(40.51)	(46.44)	(57.86)	(63.34)	(49.40)	(10.23)	(9.83)	(11.00)
15% Agricultural Credit	13.54	4.34	12.64	10.86	19.22	7.35	23.67	65.49	67.67	41.91
25% Total	(0.72)	(19.66)	(27.87)	(35.58)	(38.65)	(55.99)	(25.73)	55.26	57.85	30.90
Compliance Ratio 3 (%)										
10% Agrarian Reform Credit	5	4	2	2	2	2	5	9	9	9
15% Agricultural Credit	20	16	17	17	18	16	17	22	22	19
25% Total	25	20	20	19	20	18	22	31	31	28
Share of Altrntve to Tot Compl (%)										
10% Agrarian Reform Credit							64.2	57.5	68.4	66.8
15% Agricultural Credit							8.0	8.1	11.8	13.4
25% Total Requirement							20.6	22.1	28.0	30.2

Source: *Bangko Sentral ng Pilipinas* (BSP). Data from 1975-1985 sourced from DER; ^b from 1986-87 from SES I; ^c for 1993, from SRCAD

1/ Inclusive of alternative compliance

2/ Alternative compliance was introduced beginning 1999, which include bonds (ERAP, LGU, Pag-Ibig); 10-yr LBP agricultural bonds; Quedancor equity/investment bonds; investments in HVC Projects; development loan incentives, low-cost housing; other govt securities (MOR, Sec X341.3); special purpose treasury bonds for CARP (Cr. 301)

3/ Total Compliance /Total Loanable Funds

a/ Data has not been available for the period 1988-1992 due to a relaxation of BSP rules on the Agr-Agra Law.

b/ DER data include those of foreclosed banks.

c/ Data from SES I and SRCAD include only those banks which are operating as of end of the period.

d/ No data available. BSP stopped monitoring compliance for agrarian reform credit on direct loans and government securities since 1993.

e/ As of June 30, 2002

* Amended

Table 2. Some of the Proposed Incentives Under House Bill 1930 for Banking Institutions to Comply with PD 717

<p>A. Reduction of the Gross Receipt Tax (GRT) rates on interests, commissions and discounts from loans, credit lines and similar credit accommodations extended by financial institutions to small farmers.</p>	
<p>Outstanding Maturity</p> <p>5 years & beyond 3 yrs but < 5 yrs Less than 3 yrs</p>	<p>GRT Rate</p> <p>Exempt 0.5% 2.5%</p>
<p>B. Imputation of higher compliance rates to the mandatory loan quota if loans, credit lines and similar credit accommodations are made directly to agrarian reform beneficiaries and/or eligible agricultural activities.</p>	
<p>Outstanding Maturity or Type of Loan</p> <p>1) Financing with a maturity of five years and beyond for the provision, maintenance and upgrade of a component of the rural support system</p> <p>2) Financing with an outstanding maturity of less than five (5) years for purposes cited in 1 above</p> <p>3) Financing extended to LGUs, specifically for rural development</p>	<p>PD 717 Compliance Rate</p> <p>Computed at four times the outstanding value of the loans</p> <p>Computed at twice the amount of the outstanding value of the loans</p>

