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REDISCOUNTING, SAVINGS MOBILIZATION, AND THE RURAL BANKING SYSTEM

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The paper assesses the performance of rural banks, particularly the role of rediscounting and savings mobilization in enhancing their viability. Evidence suggests that Philippine rural financial institutions can mobilize savings as a reliable source of funds for a financial market which is becoming increasingly dependent on competition and efficiency. It notes that new policies geared towards the rural banking system will be effective if they are viewed as permanent rather than temporary.

The major policy thrust of the new Philippine government is an agriculture-based development strategy which relies on two key elements: (a) removal of price biases against agriculture, and (b) improvement in agricultural productivity (Alburo, *et al.*, 1986). This strategy requires an efficient delivery of agricultural credit services. Ironically, the existence and survival of the credit delivery system in agriculture — the rural banking system — are threatened by policies designed to induce a market-related pricing scheme of rural financial services.

Several factors come to play in this dilemma. Rediscounting and savings mobilization have been frequently cited in the literature as two major, at times, conflicting programs in rural finance. How do we assess the performance of rural banks? How adequate are their capital funds? Does rediscounting or savings mobilization enhance the viability of rural banks? This paper addresses these questions. Our presentation is divided into four sections. The next section assesses the financial performance of rural banks at the regional level. This is followed by additional sections that evaluate the capital adequacy of rural banks, and the merits of rediscounting vis-a-vis savings mobilization. The last section gives the concluding remarks.

Financial Performance in Regional Perspective

A closer look at the performance of rural banks shows that there are significant regional disparities in various aspects of the

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distribution of resources. For instance, Table 1 indicates that during the last two years, the regions of Ilocos, Central Luzon, Southern Tagalog and Western Visayas accounted for slightly over 60 per cent of total resources and loan portfolio (it will reach approximately 70 per cent if the Bicol region is included). Consequently, these regional disparities are likewise reflected in these particular regions' dominance in the rural banking system's ability to attract deposits and to engage in borrowings (consisting of bills payable and special time deposits) from the Central Bank. Looking at the percentage shares of net income by region, Table 1 evidently shows that the rural banks from the regions of Southern Tagalog and Western Visayas have disproportionate shares. This observation is partly explained by a greater number of units operating in these regions. However, on a per bank basis, Western Visayas has the highest net income per unit, and Bicol has the lowest (in absolute terms).

Table 2 compares rural banks with commercial banks, thrift banks, and specialized government banks in terms of resources, loans, and deposits at the regional level. It is obvious that regions heavily favored by rural banks in terms of undue concentration of their resources, loans, and deposits are practically the same regions heavily served by commercial banks, thrift banks, and government specialized banks. The other exception is the huge exposure of these other institutions at the National Capital Region. For commercial banks and thrift institutions, Central Visayas and Central Mindanao are deposit-generating regions. Note that the loan-deposit ratio (see Table 3) for commercial banks is higher in Western Visayas than in the National Capital Region. The lending exposure of commercial banks to the sugar industry in Western Visayas explains this high ratio. Thrift banks are not as successful in generating deposits as they are in giving out loans in the Bicol region. Specialized government banks seem to be favoring depressed areas (Cagayan Valley, Western Visayas, Eastern Visayas, Northern Mindanao, and Central Mindanao) in their lending policy. Rural banks' inability to generate deposits is dramatized by the extremely high loan-deposit ratios in all regions particularly in Bicol, Western Visayas, Northern Mindanao, Central Mindanao, and Eastern Visayas.

Table 4 shows that rural banks in Bicol, Cagayan Valley and most of the Visayas and Mindanao regions have high ratios of past due loans to total loans. Loan delinquency (Adams and Vogel, 1984) in depressed areas can be explained as due to

Table 1 — Regional Percentage Shares in Some Selected Accounts:1984-1985

Region	Resources		Loan Portfolio		Past Due Loans		Deposits		Borrowings		Net Worth		Gross Income		Total Expenses		Net Income	
	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985	1984	1985
Ilocos	12.9	12.7	13.5	13.6	11.7	13.2	12.6	12.1	14.1	14.7	11.4	11.0	13.2	12.0	13.6	12.6	9.2	4.3
Cagayan Valley	4.0	4.1	3.8	3.9	3.8	3.7	4.0	4.0	3.3	3.2	5.0	4.9	4.2	4.5	4.2	4.6	4.7	4.6
Central Luzon	16.3	17.2	16.1	16.7	14.5	13.7	18.4	20.1	13.5	14.3	12.5	13.2	16.2	16.7	17.1	17.5	7.8	7.0
National Capital	1.9	1.8	1.3	1.3	1.1	1.0	3.5	3.8	0.3	0.2	1.8	1.8	2.3	2.3	2.4	2.4	1.6	0.2
Southern Tagalog	20.2	19.8	18.8	18.0	16.2	15.8	30.4	30.8	14.2	12.1	18.5	18.1	23.8	24.5	24.0	24.0	22.0	30.7
Bicol	7.4	7.0	8.2	7.7	11.2	10.8	3.4	3.2	11.0	10.8	6.7	6.6	6.6	5.3	7.0	5.7	2.1	0.7
Western Visayas	11.1	10.6	11.7	11.3	12.4	11.4	6.8	5.9	14.0	13.8	14.1	13.7	9.3	8.9	8.2	8.4	20.1	14.6
Central Visayas	7.5	7.6	7.4	7.3	8.3	8.9	6.9	6.8	8.2	8.3	8.5	8.4	7.6	8.4	7.5	8.1	9.1	11.5
Eastern Visayas	2.8	2.7	3.0	3.1	3.4	3.4	2.3	1.9	3.2	3.4	2.9	3.4	2.7	2.6	2.6	2.4	3.9	4.7
Western Mindanao	1.5	1.5	1.2	1.3	1.2	1.3	1.4	1.3	1.1	1.2	2.6	2.9	1.5	1.7	1.3	1.4	3.4	5.8
Northern Mindanao	5.7	5.7	6.0	5.9	6.1	6.8	3.4	3.1	7.0	7.3	6.7	6.5	4.8	4.7	4.7	4.7	5.3	4.7
Southern Mindanao	5.1	5.6	5.2	5.8	5.7	6.1	4.4	4.6	5.7	6.0	5.3	5.4	5.2	5.5	5.0	5.4	6.4	6.8
Central Mindanao	3.6	3.7	3.8	4.1	4.4	3.9	2.4	2.4	4.4	4.7	4.0	4.1	2.6	2.9	2.4	2.8	4.4	4.3
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: *Philippine Rural Banking System: 1984 and 1985 Annual Reports* (Manila: Central Bank of the Philippines).

Table 2 -- 1985 Average Resources, Average Loan Portfolio and Average Deposit Liabilities Per Banking Office Within Each Bank Group by Region (In Million Pesos)

Region	Commercial Banks			Thrift Banks			Rural Banks			Specialized Government Banks		
	Resources	Loans	Deposits	Resources	Loans	Deposits	Resources	Loans	Deposits	Resources	Loans	Deposits
Ilocos	44.3	8.2	39.8	13.2	3.3	10.2	7.6	6.0	2.5	88.4	67.3	16.8
Cagayan Valley	38.3	12.7	30.1	18.0	6.2	12.8	5.3	3.8	1.8	152.0	127.2	4.9
Central Luzon	47.6	11.5	39.1	15.0	5.2	12.2	10.5	7.6	4.3	205.9	177.9	23.8
National Capital	376.1	143.7	134.6	60.6	27.6	26.9	8.1	4.2	6.1	16,580.4	5,320.1	1,195.8
Southern Tagalog	45.9	10.9	36.7	14.4	4.4	9.9	7.7	5.2	4.2	70.0	46.5	15.0
Bicol	35.3	12.6	28.3	15.0	7.5	6.9	8.1	6.7	1.3	57.3	46.8	8.2
Western Visayas	83.5	51.1	41.0	15.7	6.0	9.9	7.7	6.1	1.5	100.2	75.3	6.7
Central Visayas	64.8	22.5	52.6	20.3	5.4	14.5	7.7	5.6	2.4	80.3	62.7	13.6
Eastern Visayas	39.6	13.6	32.1	17.6	0.5	14.2	4.8	4.0	1.2	57.4	47.3	2.8
Western Mindanao	42.2	11.7	38.6	19.2	2.1	18.0	6.0	3.7	1.7	49.5	36.4	5.9
Northern Mindanao	40.9	14.8	32.8	8.4	2.8	6.2	7.1	5.6	1.3	74.7	59.1	4.8
Southern Mindanao	45.3	16.5	38.4	17.2	6.0	10.4	7.8	6.1	2.3	106.9	86.1	11.8
Central Mindanao	48.5	14.3	39.0	22.6	5.4	18.0	7.1	5.8	1.6	77.0	55.7	4.9
Highest Average	376.1	143.7	134.6	60.6	27.6	26.9	10.5	7.6	6.1	16,580.4	5,320.1	1,195.8
Lowest Average	35.3	8.2	28.3	8.4	0.5	6.2	4.8	3.7	1.2	49.5	36.4	2.8
National Average (excluding National Capital)	48.0	16.7	37.4	16.4	4.6	11.9	7.3	5.5	2.2	93.3	74.0	9.9

Source: *1985 Fact Book: Philippine Financial System* (Manila: Central Bank of the Philippines).

Table 3 -- 1985 Loan Portfolio to Deposit Ratio by Region
(In Per cent)

Region	Banking System	Banking Groups			
		Commercial Banks	Thrift Banks	Rural Banks	Specialized Government Banks
Ilocos	46.0	20.7	32.0	237.1	401.7
Cagayan Valley	128.0	42.2	48.6	207.8	2,581.4
Central Luzon	59.7	29.4	42.7	175.6	747.9
National Capital	123.1	106.7	102.6	69.0	444.9
Southern Tagalog	51.2	29.6	44.7	124.0	310.8
Bicol	97.6	44.4	109.3	511.5	571.1
Western Visayas	142.6	124.5	60.4	409.2	1,116.9
Central Visayas	53.7	42.8	37.4	229.4	461.5
Eastern Visayas	82.0	42.4	3.5	348.0	1,687.8
Western Mindanao	55.2	30.3	11.5	213.8	612.8
Northern Mindanao	84.5	45.2	45.4	418.7	1,229.3
Southern Mindanao	74.7	42.9	57.8	269.3	728.8
Central Mindanao	83.1	36.6	29.7	367.0	1,126.0

Source: *1985 Fact Book: Philippine Financial System* (Manila: Central Bank of the Philippines).

Table 4 — Selected Financial Ratios by Region for 1984
(In Per cent)

Region	Liquid Assets to Deposits	Past Due Loans to Total Loans	Deposits to Borrowings	Net Worth To Risk Assets	Net Worth to Liabilities
Ilocos	29.7	31.6	64.7	14.4	15.1
Cagayan Valley	26.5	36.3	88.1	20.6	22.7
Central Luzon	25.7	32.7	99.1	12.7	12.8
National Capital	49.6	30.9	932.1	16.7	17.1
Southern Tagalog	29.0	31.3	156.3	15.7	15.7
Bicol	42.5	49.5	22.4	14.4	15.4
Western Visayas	42.8	38.4	35.3	20.1	23.2
Central Visayas	38.0	40.5	61.6	18.3	20.1
Eastern Visayas	35.0	41.1	53.7	16.4	18.2
Western Mindanao	57.8	34.0	90.9	29.8	34.6
Northern Mindanao	52.9	37.5	35.7	18.6	20.9
Southern Mindanao	35.2	39.5	56.3	16.5	17.9
Central Mindanao	41.0	41.2	40.0	17.7	19.8
OVERALL	33.0	36.3	72.8	16.4	17.4

Source: *Philippine Rural Banking System: 1984 Annual Report* (Manila:Central Bank of the Philippines).

farmers' inability to repay when unexpected events (e.g. price declines, crop failures, typhoons and economic crises) or structural problems (e.g., absence of farm-to-market roads, post-harvest wastage, small markets, and obsolete technology) affect them. Another explanation is that farmers are unwilling to repay because they consider loans granted by government-subsidized rural banks as "welfare grants or political patronage." Either of the two explanations is applicable to the high loan delinquency in the depressed areas of the country. What needs to be examined beyond this study is the determination of the underlying costs and benefits to a farmer who repays compared to the costs and benefits of one who does not. What role does incentive play to achieve low delinquency rates? These issues are beyond the scope of this study, nonetheless they ought to be answered in further research work in this area.

Further evidence of the rural banking system's financial situation is shown in Tables 5 and 6. Table 5 has shown that the Ilocos, Bicol, and National Capital regions have consistently registered lower return on assets (ROA) for 1984 and 1985. In terms of the net income to gross income ratio, Western Mindanao has consistently performed as the most efficient among the regions for 1984 and 1985, despite the evidence shown in Table 1 that this region has only 1.5 per cent share of total rural bank resources in 1984 and 1985.

Looking at the performance of the rural banking system from 1980 to 1985 (see Table 6), loan delinquency has worsened and profitability has declined in the last two years.

It is clear from Table 6 that rural banks' borrowings from the Central Bank have declined but its deposit generation was not as successful to replace the declining availability of the CB's rediscounting advances.

Capital Adequacy

The strength of our organization, such as a bank, should be measured in terms of its capital funds. Adequate bank capital reassures the public and supports confidence in banks (Rosse and Hempel, 1980). In appraising the capital adequacy of rural banks vis-a-vis other banking institutions, we have utilized and measured three indicators: capital to total deposits, capital to

Table 5 -- Philippine Rural Banking System: A Return on Assets, Return on Net Worth, Asset to Liabilities, and Net Income to Gross Income Ratios, by Region, 1984-1985

Region	Return on Assets (Per Cent)		Return on Net Worth (Per Cent)		Total Assets / Total Liabilities		Net Income / Gross Income	
	1984	1985	1984	1985	1984	1985	1984	1985
Ilocos	0.80	0.33	6.12	2.43	1.15	1.16	6.5	2.7
Cagayan Valley	1.32	1.10	7.12	5.86	1.23	1.23	10.3	7.6
Central Luzon	0.54	0.40	4.74	3.31	1.13	1.20	4.5	3.2
National Capital	0.94	0.07	6.43	0.43	1.17	1.19	6.3	0.8
Southern Tagalog	1.22	1.53	8.97	10.59	1.16	1.17	8.6	9.4
Bicol	0.32	0.10	2.43	0.69	1.15	1.18	3.0	1.0
Western Visayas	2.04	1.36	10.80	6.66	1.23	1.26	20.2	12.4
Central Visayas	1.35	1.50	8.06	8.49	1.20	1.21	11.1	10.3
Eastern Visayas	1.60	1.71	10.41	8.72	1.18	1.24	13.5	13.6
Western Mindanao	2.61	3.73	10.13	12.46	1.35	1.43	21.4	24.7
Northern Mindanao	1.03	0.08	5.96	4.48	1.21	1.22	10.2	7.6
Southern Mindanao	1.40	1.21	9.22	7.87	1.18	1.18	11.6	9.3
Central Mindanao	1.34	1.13	8.10	6.44	1.20	1.21	15.4	10.9
TOTAL	1.12	0.98	7.57	6.23	1.17	1.19	9.3	7.5

Source: *Philippine Rural Banking System: Annual Report*, 1984 and 1985 Issues (Manila: Central Bank of the Philippines).

Table 6 — Selected Financial Ratios: Rural Banking System, 1980-1985
(In Per Cent)

	1980	1981	1982	1983	1984	1985	Average
1. Liquid assets (cash and due from banks to deposits)	27.6	26.7	27.0	28.7	33.0	33.8	29.5
2. Past due loans to total loan portfolio (gross)	26.8	26.3	24.6	22.2	36.3	42.7	29.8
3. Net worth to risk assets	14.4	14.6	13.7	14.3	16.4	16.6	15.0
4. Net worth to deposits and borrowings	16.8	16.7	15.6	16.1	19.2	21.0	17.6
5. Net income to gross income	14.5	14.0	12.1	10.1	9.3	7.5	11.3
6. Net income to average paid-up capital	17.0	16.5	14.5	12.0	10.6	8.5	13.2
7. Net income to average combined capital accounts	11.0	11.4	10.0	9.0	7.8	6.4	9.3

Source: *Philippine Rural Bank System Annual Report, 1984 and 1985* (Manila: Central Bank of the Philippines).

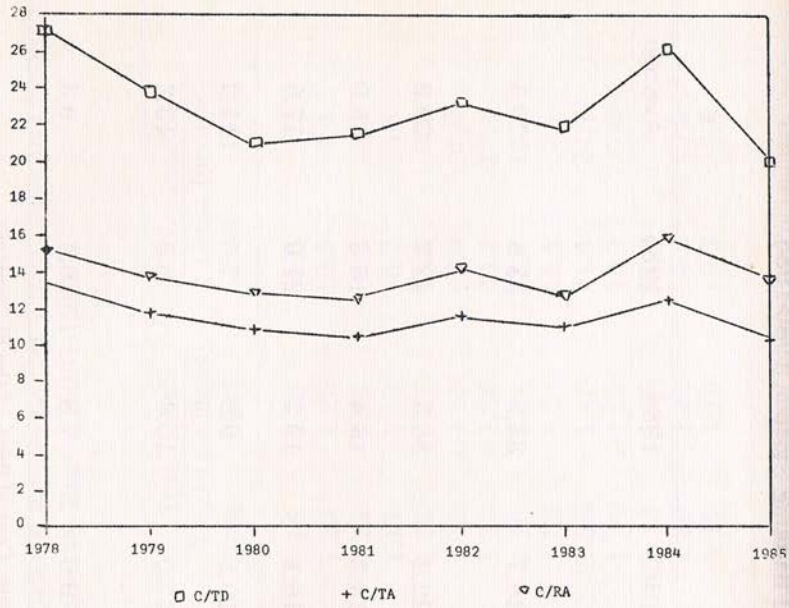


Figure 1 — Commercial Banking System

total assets, and capital to risk assets.[1] The accepted rule of thumb is that a bank's capital funds should be at least 10 per cent of its deposit liabilities, 7 per cent of its total assets, and 20 per cent of its risk assets (Rosse and Hempel, 1980).

Table 7 shows the values of the capital/total deposits, capital/total assets, and capital/risk asset ratios for all banking groups from 1978 to 1985. Figures 1 to 6 plot these ratios for commercial banks, private development banks, thrift banks, rural banks, and the entire Philippine banking system. Commercial banks (as shown in Figure 1) pass the capital adequacy test in terms of capital/total deposits and capital/total assets ratios for the entire period. However, commercial banks fail in terms of the capital/risk assets or the risk asset ratio. They have consistently maintained a risk asset ratio below the standard of 20 per cent. Even if we utilize the average of the banking system as our "critical" value, commercial banks still fail to pass the capital adequacy test: that is, their risk asset ratios consistently fall below the average of the banking system. Private development banks (see Figure 2), which are a subset of thrift banks,

[1] Risk assets are defined as total assets less cash, bank balances, and government securities. Risk assets in this study are defined as total assets less cash because data on bank balances and government securities are not available.

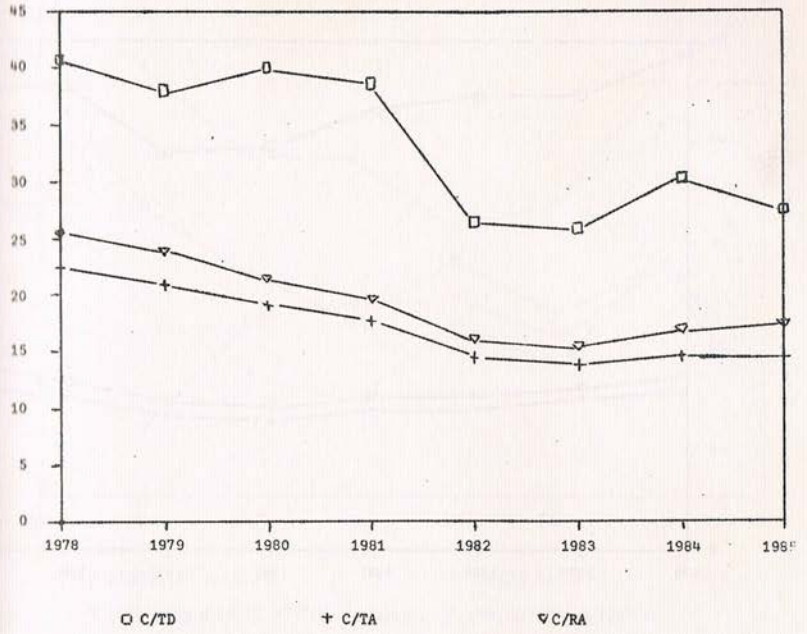
	1978	1979	1980	1981	1982	1983	1984	1985
I. Philippine Banking System								
a. Capital/Total Deposits (%)	33.12	29.01	25.68	25.77	27.68	26.34	31.50	23.92
b. Capital/Total Assets (%)	14.70	12.97	12.03	11.45	12.22	11.52	12.19	10.13
c. Capital/Risk Assets (%)	16.37	14.91	13.98	13.40	14.49	13.17	14.74	12.55
II. The Commercial Banking System								
a. Capital/Total Deposits (%)	27.15	23.71	20.86	21.36	23.19	21.72	26.15	19.95
b. Capital/Total Assets (%)	13.26	11.57	10.72	10.30	11.39	10.80	12.38	10.29
c. Capital/Risk Assets (%)	15.11	13.59	12.78	12.47	14.05	12.67	15.80	13.56
III. Thrift Banks								
a. Capital/Total Deposits (%)	12.78	12.09	15.09	16.17	15.83	16.11	26.20	15.78
b. Capital/Total Assets (%)	10.52	9.93	11.43	11.63	11.72	11.18	12.19	10.85
c. Capital/Risk Assets (%)	11.49	11.37	13.31	13.17	13.28	12.37	13.78	12.96
IV. Private Development Banks								
a. Capital/Total Deposits (%)	40.60	37.75	39.81	38.45	26.30	25.65	30.20	27.34
b. Capital/Total Assets (%)	22.26	20.89	19.03	17.68	14.41	13.75	14.58	14.56
c. Capital/Risk Assets (%)	25.53	23.79	21.26	19.54	15.91	15.25	16.79	17.32
V. Savings and Mortgage Banks								
a. Capital/Total Deposits (%)	7.84	7.02	10.17	8.09	8.93	9.49	21.13	6.94
b. Capital/Total Assets (%)	7.07	6.43	8.46	6.94	7.74	7.65	8.42	5.75
c. Capital/Risk Assets (%)	7.60	7.28	10.01	7.85	8.41	8.48	9.35	6.90

Table 7 (Continued)

VI. Stock Savings and Loan Assocs.								
a. Capital/Total Deposits (%)	21.40	23.78	25.11	21.63	22.22	21.85	30.06	25.25
b. Capital/Total Assets (%)	15.32	16.48	17.49	15.41	16.21	14.65	18.57	15.96
c. Capital/Risk Assets (%)	17.17	18.62	19.74	17.99	18.95	16.09	21.42	19.00
VII. Rural Banking System								
a. Capital/Total Deposits (%)	48.64	44.70	44.42	43.06	39.37	38.89	45.54	45.07
b. Capital/Total Assets (%)	15.57	14.89	13.66	13.62	12.69	13.04	14.81	15.82
c. Capital/Risk Assets (%)	17.01	15.72	14.93	14.88	13.90	14.43	16.59	17.95
VIII. Specialized Government Banks								
a. Capital/Total Deposits (%)	114.49	105.05	84.23	63.24	80.60	112.04	166.47	109.74
b. Capital/Total Assets (%)	21.47	19.65	17.56	15.69	15.50	14.44	11.22	8.92
c. Capital/Risk Assets (%)	22.04	20.86	18.62	16.48	16.40	15.06	11.63	9.34

Source: *1985 Fact Book: Philippine Financial System* (Central Bank: Manila, 1986).

Figure 2 — **Private Development Banks**



are obviously less risky than commercial banks. Risk asset ratios for private development banks are more favorable than those of commercial banks. Although risk asset ratios for private development banks fall below 20 per cent beginning in 1982, they are still comfortably above the average for the banking system. The case of the rural banking system is presented in Figure 3 which shows that rural banks have the highest capital/total deposit ratios compared to those of commercial banks and private development banks. The major explanation for these high values is the rural banks' obvious inability to mobilize deposits in the rural areas. Rural banks seem to have adequate capital in terms of capital/total asset ratios, but they seem to have inadequate capital in terms of risk asset ratios. At any rate, rural banks are better off in the sense that their risk asset ratios are consistently above those (except in 1982) of the commercial banks and the banking systems, respectively. Thrift banks composed of private development banks, savings and mortgage banks, and stock savings and loan associations have the lowest capital/total deposit ratios (as shown in Figure 4) which are even lower than the average for the banking system. In terms of capital/total asset ratios (see Figure 5), the thrift banks have overtaken commercial banks in 1980, and the latter has the lowest, and the

Figure 3 — Rural Banking System

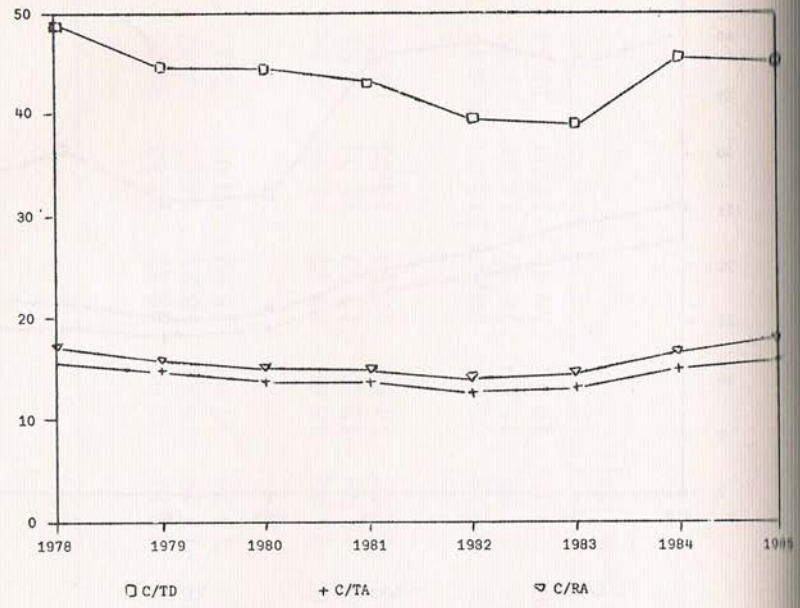


Figure 4 — Capital/Total Deposits

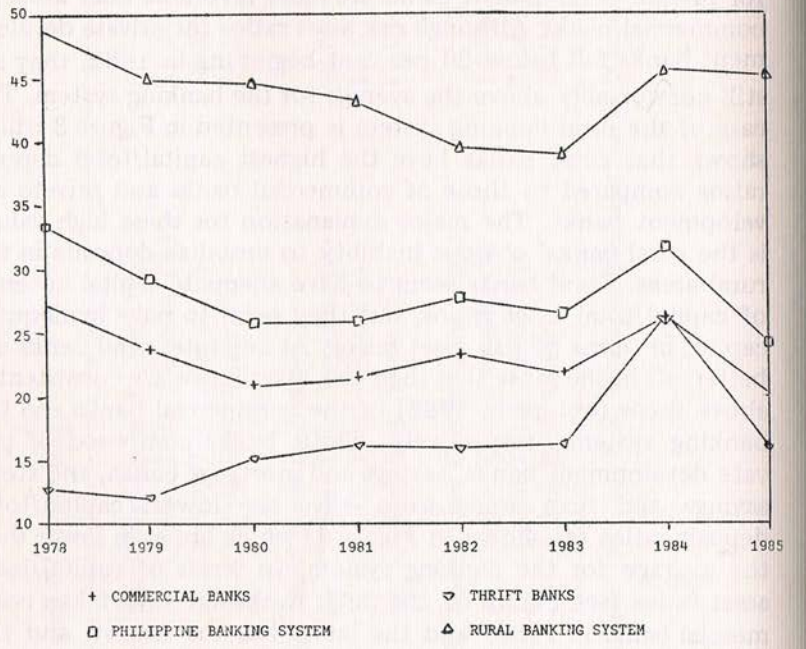
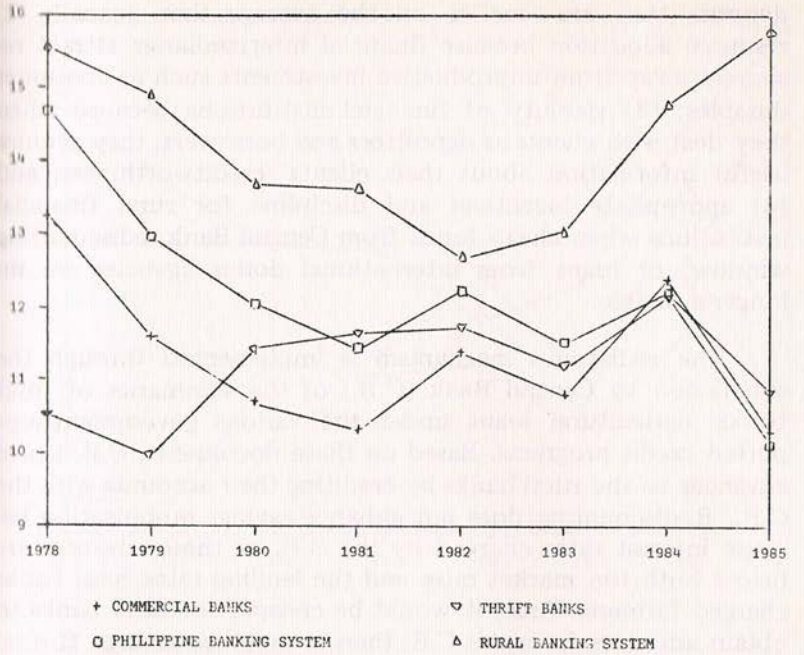


Figure 5 — Capital/Total Assets



rural banks have the highest ratios. And Figure 6 shows the trend in terms of risk asset ratio. Rural banks have maintained an adequate ratio (except in 1982) compared to other banking institutions, and it continues to increase since 1982. On the contrary, the risk asset ratio for commercial banks is higher than that of the banking system after 1983, but it sharply drops after 1984. Thus, while the profitability of the rural banking system clearly decreases from 1984 to 1985 (see Table 5), relative capital adequacy of operating rural banks is improving.

Savings Mobilization Versus Rediscounting

Savings mobilization has not been stressed in low-income countries because low-interest lending for agriculture has been thought to be the appropriate policy as it was then generally accepted that rural people in these countries have no capacity to save and do not respond to incentives such as higher interest rates. Some researchers (Adams, 1973; Adams, 1978; Adams, 1984; Vogel, 1984; and Adams and Vogel, 1984) have argued and documented that savings can be mobilized in rural areas of low-income countries as long as appropriate incentives exist. Vogel (1984), in particular, argues that savings mobilization promotes: (1) income redistribution because "financial inter-

mediaries serve more savers than borrowers and have individual deposits that are smaller on the average than loans"; (2) resource allocation because financial intermediaries attract resources away from unproductive investments such as consumer durables; (3) viability of financial institutions because when they deal with clients as depositors and borrowers, they acquire useful information about their clients' creditworthiness; and (4) appropriate incentives and discipline for rural financial institutions when cheap funds from Central Bank rediscounting window, or loans from international donor agencies are no longer available.

The rediscount mechanism is implemented through the submission to Central Bank (C.B.) of the summaries of rural banks' agricultural loans under the various government-supported credit programs. Based on these documents, C.B. issues advances to the rural banks by crediting their accounts with the C.B.. Rediscounting does not enhance savings mobilization because interest rates charged by the C.B. on these advances are below both the market rates and the lending rates rural banks charged farmers. Thus, it would be cheaper for rural banks to obtain advances from the C.B. than to mobilize savings. If rural banks mobilize savings by offering higher deposit rates, the low-interest lending policy guarantees that rural banks' interest and administrative costs will be greater than its interest income on loans. It has been claimed that an effective saving mobilization and loan recovery program has potentially greater effects than an effective program of subsidized loans from government lending institutions and grants from international donor agencies (Vogel, 1984; Adams and Vogel, 1984).

Presently the Philippine rural banking system is facing the effects of the 1980 financial reforms which stressed efficiency in the competitive marketplace through savings mobilization. The adoption of market-related rediscount rate, gradual withdrawal of C.B.'s rediscounting facilities, and immediate withdrawal of tax exemptions are policies intended to emphasize savings mobilization in the rural banking system. It has been reported (Lamberte, 1985) that the "growth rates in deposits per bank were particularly higher during the floating interest rate regime" which supports the contention of other researchers that people in rural areas positively respond to incentives. Table 8 and Figure 7 show that rural banks' savings deposits have started to move upward since 1980, and continued its upward trend after the 1983 economic crisis which is responsible for a

Figure 6 — Capital/Risk Assets

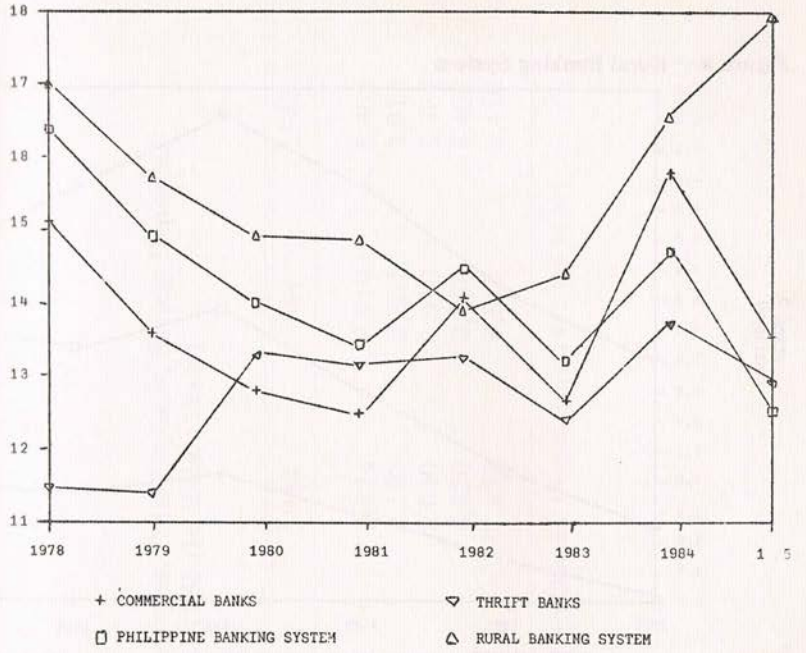


Figure 7 — Rural Banking System

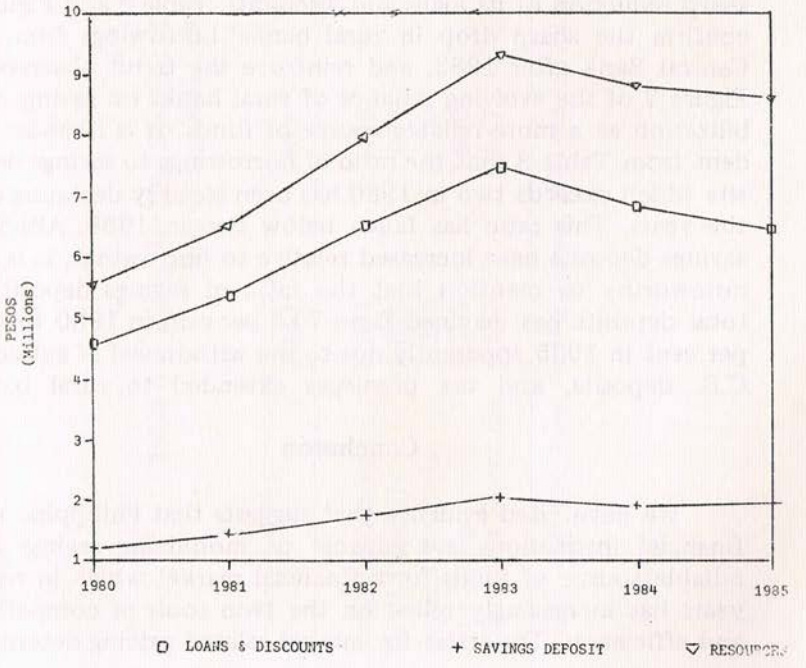
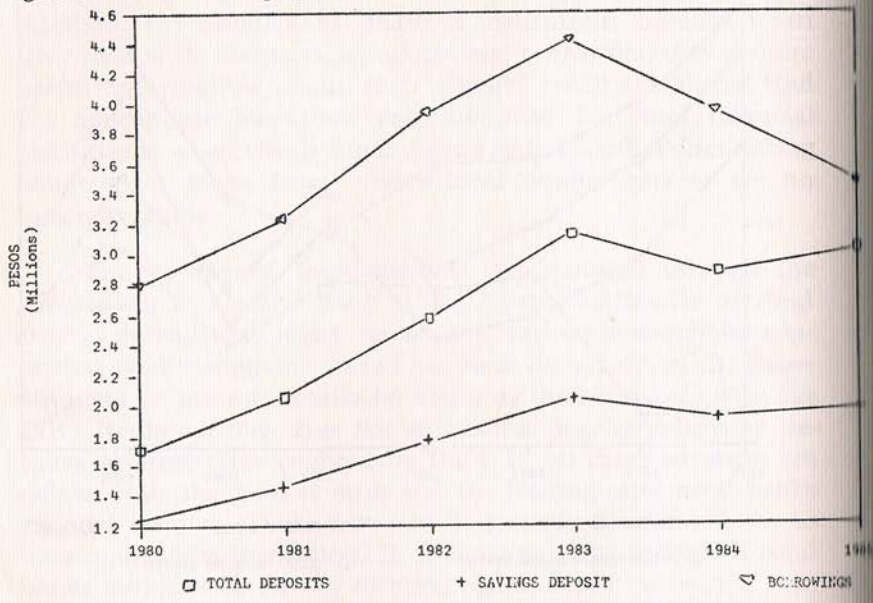


Figure 8 — Rural Banking System



sharp reduction of its loans and discounts. Table 8 and Figure 8 confirm the sharp drop in rural banks' borrowings from the Central Bank after 1983, and reinforce the trend observed in Figure 7 of the evolving reliance of rural banks on savings mobilization as a more reliable source of funds. It is likewise evident from Table 8 that the ratio of borrowings to savings deposits which exceeds two in 1980 has been steadily declining over the years. This ratio has fallen below two in 1985. Although savings deposits have increased relative to borrowings, it is also noteworthy to mention that the ratio of savings deposits to total deposits has declined from 73.3 per cent in 1980 to 65.2 per cent in 1985 apparently due to the withdrawal of subsidies, C.B. deposits, and tax privileges extended to rural banks.

Conclusion

We have cited evidence that suggests that Philippine rural financial institutions are capable of mobilizing savings as a reliable source of funds for a financial market which in recent years has increasingly relied on the twin tools of competition and efficiency. The stress for market-related pricing determina-

Table 8 — Rural Banking System: Total Resources, Total Deposits, Savings Deposits, Borrowings and Loans: 1980-1985 (In Million Pesos)

	1980	1981	1982	1983	1984	1985
Total Resources	5,524	6,490	7,978	9,324	8,819	8,601
Total Deposits	1,699	2,053	2,572	3,127	2,867	3,019
Savings Deposits	1,246	1,450	1,753	2,040	1,910	1,967
Borrowings	2,797	3,229	3,930	4,420	3,938	3,466
Loans and Discounts	4,573	5,347	6,510	7,472	6,818	6,416

Source: *Philippine Rural Banking System: 1984 and 1985 Annual Reports* (Manila: Central Bank, 1985 and 1986).

tion in the financial market would accelerate the adjustment process so that rural banks would look at the prospects of their long-run survival in terms of these inevitable market realities. It would be a mistake to assume that rural bank managers have misjudged the effect of the financial reforms of 1980 on their operation.[2] They probably acted the way they did because policymakers conveyed conflicting signals: the current emphasis on market-related interest rate is inconsistent with the low-interest C.B.-assisted supervised credit programs which continue to be a major source of funds for rural banks. New policies geared towards the rural banking system will be effective if they are viewed as permanent rather than transitory. The financial reforms of 1980 have long been promulgated but rural bankers are not yet completely convinced that the days of cheap rediscount funds are over — they still believe that as long as politicians are still around, subsidized lending will continue to be a vehicle for distributing patronage.

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[2] Lamberte (1985) argues that rural banks did not anticipate such "market surprises" as the switch to market-related discount rate, sudden withdrawal of tax exemptions, and sharp reduction in the volume of rediscounting. What is more revealing is the viable operation of some rural banks despite these unanticipated policies. The quality of bank management that immediately adjusts to market shocks has to be considered.

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