WORKING PAPER

Credit Upgrades and Inclusive Growth: Examining the Links

Ronald U. Mendoza
AIM Rizalino S. Navarro Policy Center for Competitiveness

Katherine M. Peralta
AIM Rizalino S. Navarro Policy Center for Competitiveness

Enrico V. Gloria
AIM Rizalino S. Navarro Policy Center for Competitiveness

RSN-PCC WORKING PAPER 15-008

AIM RIZALINO S. NAVARRO
POLICY CENTER FOR COMPETITIVENESS

ASIAN INSTITUTE OF MANAGEMENT
RIZALINO S. NAVARRO POLICY CENTER FOR COMPETITIVENESS
WORKING PAPER

Credit Upgrades and Inclusive Growth: Examining the Links

Ronald U. Mendoza
AIM Rizalino S. Navarro Policy Center for Competitiveness

Katherine M. Peralta
AIM Rizalino S. Navarro Policy Center for Competitiveness

Enrico V. Gloria
AIM Rizalino S. Navarro Policy Center for Competitiveness

MAY 2015

Corresponding Author:
Ronald U. Mendoza, AIM Rizalino S. Navarro Policy Center for Competitiveness
Tel: +632-892-4011. Fax: +632-465-2863. E-mail: rumendoza@aim.edu

1. INTRODUCTION

Ushering in a period of renewed economic optimism, the Philippines has rapidly ascended the credit rating scales of several international credit rating agencies since 2009. Essentially, these credit rating upgrades signal to investors and lenders that the Philippines is a much more promising and far less risky investment destination, compared to the past. Just last December 11, 2014, the country received its highest rating yet in its entire history, a BAA2 from Moody's. This rating agency noted, in particular, the ongoing debt reduction, improvements in fiscal management, as well as the improved prospects for strong economic growth (Global Credit Research, 2014). Many have praised the credit upgrade as it could facilitate easier access to credit, a further impetus to the country's strong economic performance.

Nevertheless one wonders whether and to what extent these upgrades contribute to inclusive growth and poverty reduction. Despite improving macroeconomic fundamentals, competitiveness rankings, and investors' outlook, the Philippines lags significantly on some of its poverty reduction and development goals, including most notably those enshrined in the United Nations' Millennium Development Goals (MDGs).

The MDGs were crafted in September 2000 by close to 200 countries; and these goals included targets in poverty reduction, improving child health, reducing maternal mortality, promoting gender equality and combating HIV-Aids.[1] It is now inevitable that the Philippines will fail to meet its poverty reduction target of 16.6% in 2015 (or a target of halving the 33% poverty incidence rate in 1991 as set in the year 2000). The penultimate challenge lies in improving the inclusiveness of the economy for the vast majority of the nation's poor and low income families (Balisacan, 2015). They are often trapped in sectors with low productivity (e.g. agriculture or the low-skilled and informal services sector), and they are unable to access key markets that could enhance their earning power and wellbeing (e.g. credit and insurance markets).

This paper examines some of the channels through which some of the anticipated benefits from the credit upgrades are expected to flow to poor and low income households. It identifies financial inclusion as an important ingredient in further boosting economic growth and improving its inclusiveness, notably as far as its poverty reduction impact is concerned. A financially-inclusive country allows all of its citizens to have access to and knowledge of financial products and services, evening the distribution of wealth.

[1] See (United Nations Development Programme, 2001)

Nevertheless, this paper finds evidence that the credit market is still highly segmented, and non-inclusive for the vast majority of small and medium scale enterprises (SMEs) and low income households in the Philippines. SMEs account for about 65% of jobs created in the Philippines, signalling a severe lack of inclusiveness for the firms that are most expected to generate jobs (or help improve labor productivity) (Department of Trade and Industry, 2014). And among the enterprises that do gain access to cheap credit, their impact on domestic job creation is likely limited, perhaps due to the capital intensive investments being made by some firms now. (This is not necessarily bad, if this enhances the productivity of the existing labor force. Nevertheless, the country does need to generate enough employment to address the growing number of underemployed and the well over one million youth entering the labor force every year.)

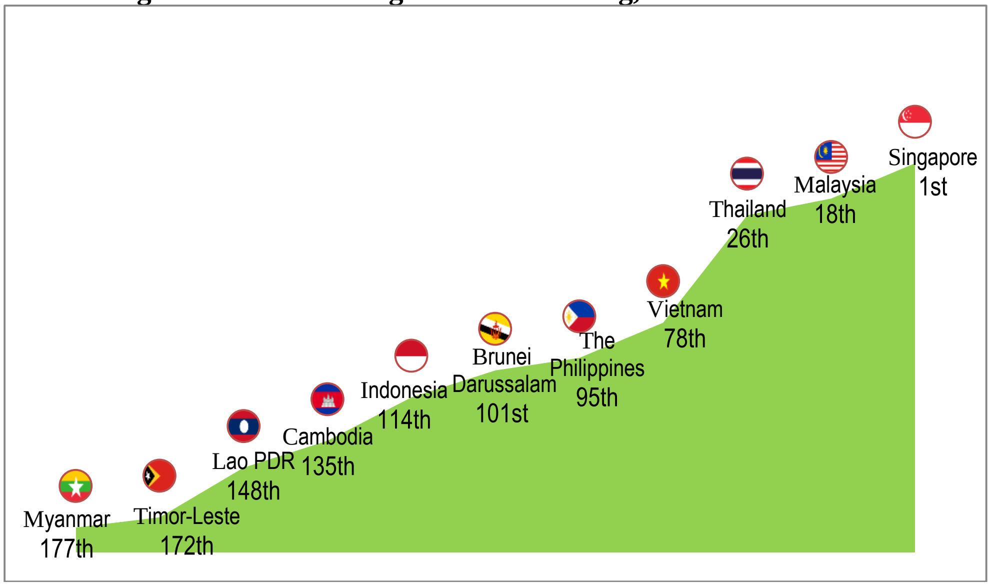
Finally, it is also likely that public sector investments are not yet as strong as could be programmed—leading to possible underinvestment in public goods. And because some key public goods can also disproportionally benefit the poor and low income population, then this also signals a severe disconnect between the credit upgrades and the vast majority of the population that hopes to benefit from them.

2. HOW INCLUSIVE IS THE CREDIT MARKET?

In principle, credit upgrades should make it easier for businesses and consumers to access financing, as investments flow into a country due to lower risk and competitive returns. Under this environment, it should be easier to borrow, encouraging more investments and new businesses that would otherwise not have taken place. However, current data does not seem to cohere with this interpretation.

Despite recent improvements in competitiveness rankings (from 87 to 52 in the past five years), the Philippines still needs to cover much ground -- it remains at the 95th spot in the World Bank's 2015 Ease of Doing Business Index. This also places the country behind Singapore, Malaysia, Thailand, and Vietnam in ASEAN.

Figure 1. Ease of Doing Business Ranking, ASEAN Countries



Source: Doing Business, The World Bank 2014.

In particular, in terms of "ease of getting credit"—one of the sub-indicators of the Doing Business Index[2]—the Philippines also has much room for improvement. This measures the strength of legal rights, depth of credit information, credit registry coverage and credit bureau coverage. On this sub-index, the Philippines ranked 104th worldwide in 2014, five spots down from the previous year. This also places the country 8th among the ASEAN countries.

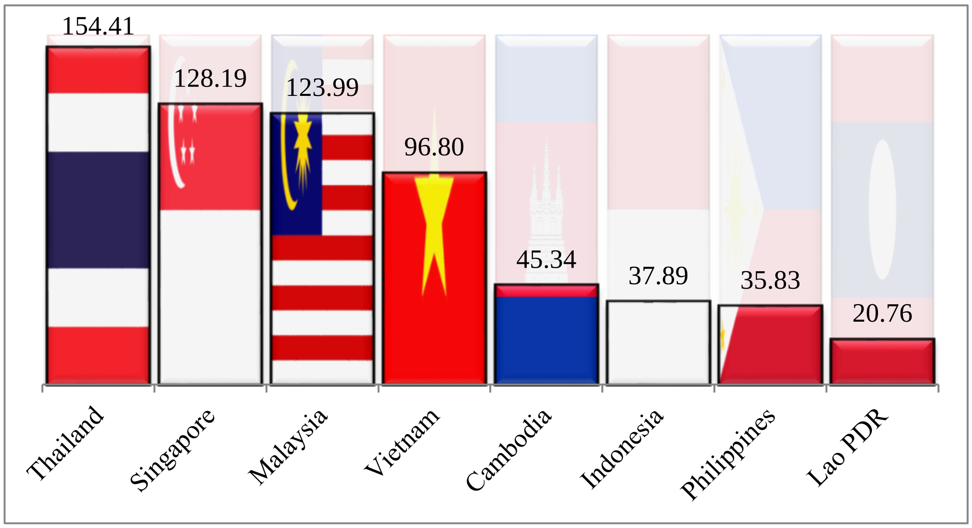
Data from the World Bank's Global Findex Database, reputed to be one of the most comprehensive data sources of global financial inclusion, similarly paints a lackluster picture for the Philippines when compared to its ASEAN neighbors. The database draws on interviews of almost 150,000 adults in over 140 countries, tracking changes in savings and financial account ownership, and exploring how adults save, borrow, make payments, and manage risk. According to the World Bank, "financial inclusion, measured by the Global Findex as having an account that allows adults to store money and make and receive electronic payments, is critical to ending global poverty."[3]

[2] See World Bank, 2015
[3] See Demirgüç-Kunt and Klapper (2015) for more information on the Global Findex Database

The Philippines has been trailing not just its ASEAN counterparts but also the rest of the world when it to comes to financial inclusion indicators. Figure 2 shows how the Philippines falls behind all ASEAN countries (excluding Lao PDR) when it comes to domestic credit to the private sector. Filipino financial corporations are only able to provide financial resources equal to just 35.83% of the country's GDP, compared to more than 100% of the country's GDP provided by their Thai, Singaporean, and Malaysian neighbors. This is despite the country's continued credit upgrades, and declining lending rate. The average bank lending rate[4] to all sectors, as reported by the Bangko Sentral ng Pilipinas, has fallen from 10% in 2004 to just about 5.5% in 2014.

Source: Demirguc-Kunt, Klapper, Singer, and Van Oudheusden 2015.

Figure 2. Domestic Credit to Private Sector (% of GDP), ASEAN Countries



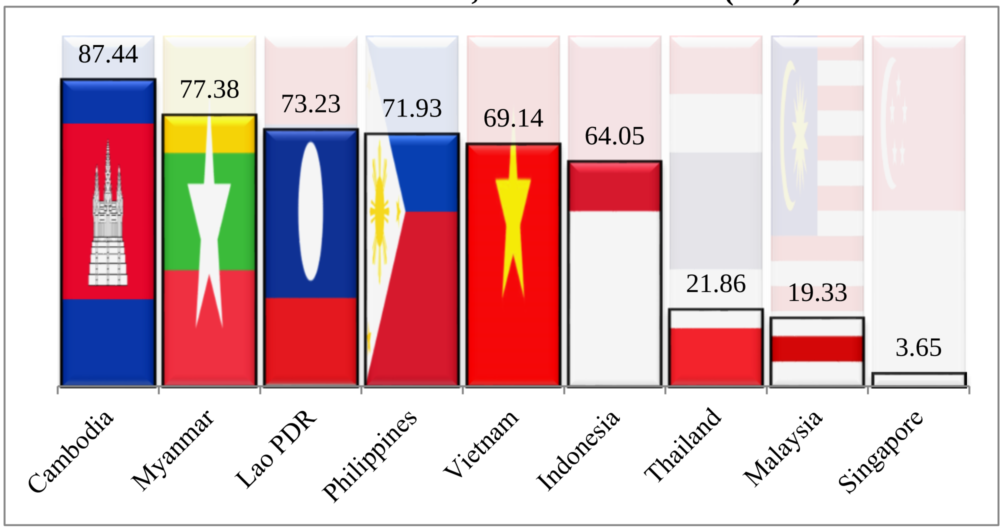
Moreover, the Philippines has a high percentage of unbanked adults (aged 15+)[5] with little improvement on this indicator. In the last three years, the country's unbanked population only decreased by less than five percent from about 73.4% in 2011 to almost 71.93% in 2014 (Figure 3). Thus, the Philippines has the 5th largest unbanked population in the ASEAN, and 52nd largest out of 172 countries in the Global Findex.

---

[4] These figures reflect the annual percentage equivalent of all commercial banks' actual monthly interest income on their peso-denominated loans to the total outstanding levels of their peso-denominated loans, bills discounted, mortgage contract receivables and restructured loans. See (BSP 2014).

[5] This is based on authors' calculations drawing on data from (Demirguc-Kunt, Klapper, Singer, and Van Oudheusden 2015).

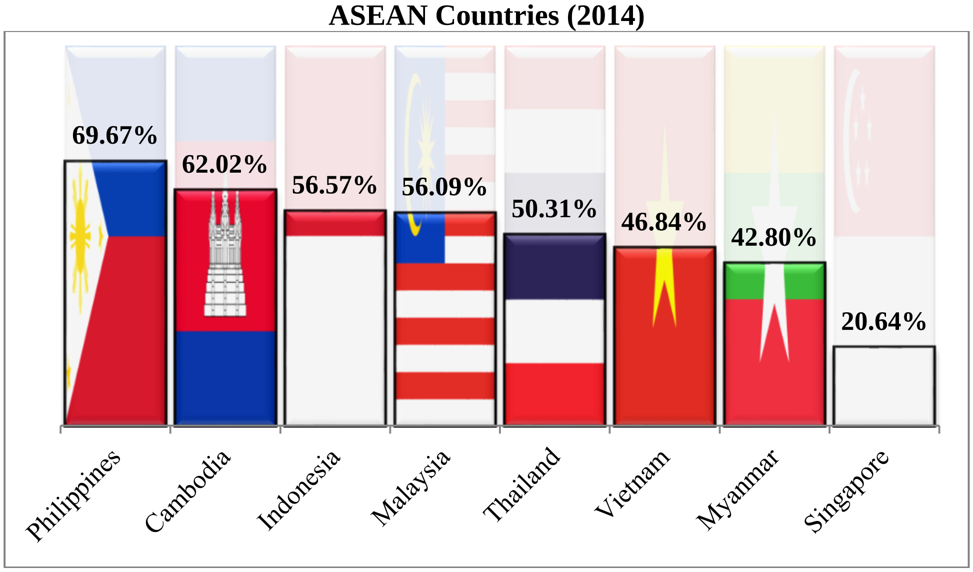
Figure 3. Percentage of the Adult Population with No Accounts with Financial Institutions, ASEAN Countries (2014)



Note: All values are for 2014 except for Lao PDR whose value is taken from 2011 data.
Source: AIM Staff Calculations drawing on data from Demirguc-Kunt, et al. 2015.

A closer look at the distribution of bank accounts provides a snapshot of how banking is even more inaccessible for the poor. While 62% of the country's richest 60% remain unbanked, the statistic is worse for the poorest 40%, where 85% have no accounts with financial institutions. This shows that the Philippines has the 44th most unbanked poor in the world, and the second most unbanked poor in the ASEAN.

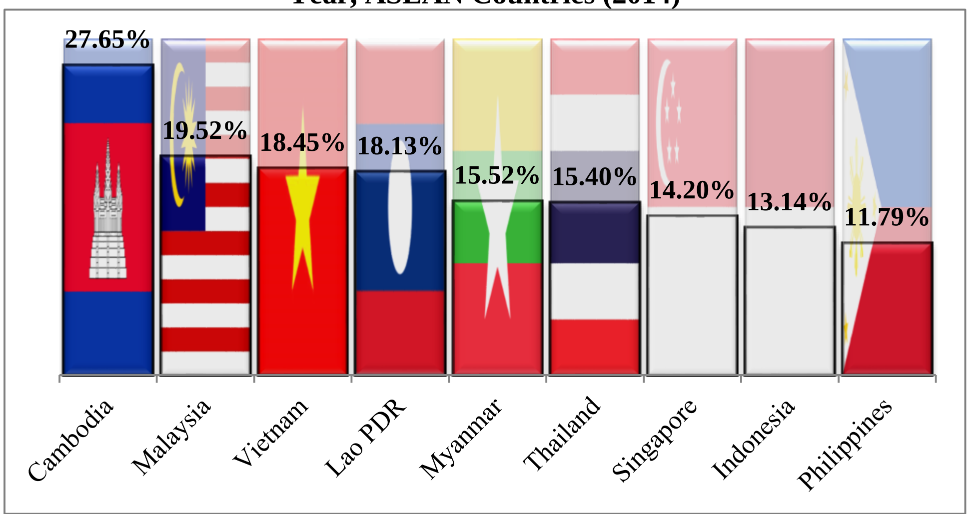
Figure 4. Percentage of the Adult Population who Borrowed in the Past Year, ASEAN Countries (2014)



Source: Demirguc-Kunt et al. 2015.

A look at the percentage of Filipinos who borrowed money in the past year, and their loan sources shows a mismatch between the Filipinos' demand for monetary funds and their subsequent supply. As shown in Figure 3, about two out of three Filipinos (69.67%) borrowed money in 2013. This puts the Philippines in the top spot in the ASEAN, and the sixth spot worldwide when it comes to largest concentration of borrowers. However, the Philippines falls behind in terms of loan borrowers with financial institutions, as Filipinos borrow heavily from private informal lenders (loan sharks), family members, friends, employees, and stores (through store credit or *palista*) rather than from banks.

Figure 5. Percentage of the Adult Population who Borrowed from Financial Institutions in the Past Year, ASEAN Countries (2014)

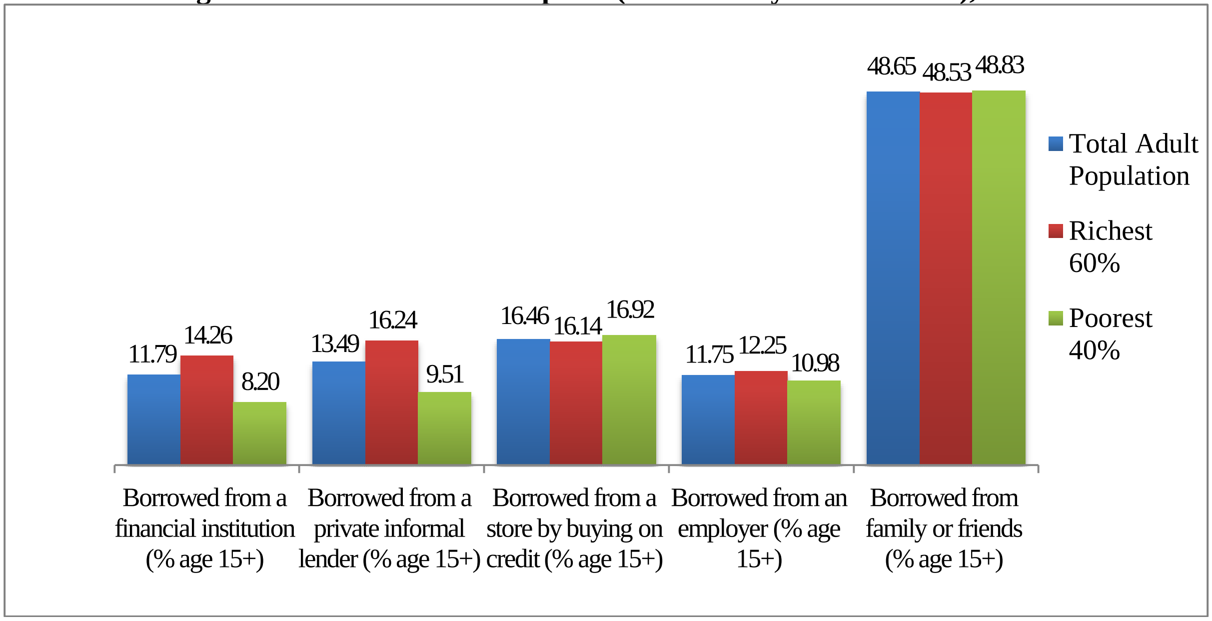


Note: All values are for 2014 except for Lao PDR whose value is taken from 2011 data.
Source: Demirguc-Kunt, et al. 2015.

Despite a high percentage of borrowers, the Philippines falls behind in the ASEAN when it comes to borrowers with formal financial institutions. Currently, only 11.79% of the country's borrowers have taken up loans with banks, credit unions, microfinance institutions or cooperative in 2013. The Philippines is constantly in the top 3 borrowers from other loan sources, and at the bottom 3 borrowers from financial institutions in the ASEAN.[6] Even worse, the poorest 40% of Filipinos are less likely to borrow from financial institutions compared to the richer 60%, with only 8.2% of the former borrowing from these institutions compared to the 14.3% of the latter (Figure 6).

[6] This is based on authors' calculations drawing on data from Demirguc-Kunt et al. (2015).

Figure 6. Loan Sources of Filipinos (Total and by Income Class), 2014



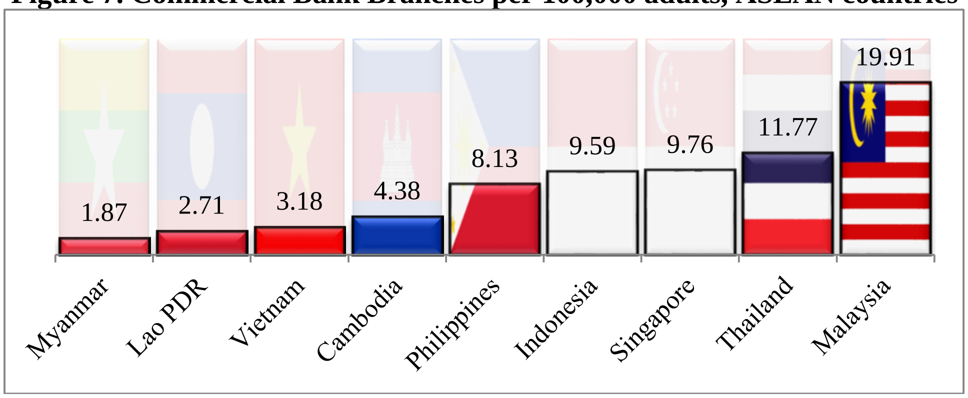
Source: AIM Policy Center staff calculations based on data from Demirguc-Kunt, et al., 2015.

Filipinos also seem to prefer borrowing from persons or groups other than banks or any other financial organization. Compared to the 11.79% of the population who borrowed from financial institutions, 13.49% and 16.46% borrowed from a private informal lender, and from a store through credit, respectively. Filipinos often borrow from stores by buying on credit or through *pagpapalista*. The Philippines has the highest percentage of borrowers in this category amongst ASEAN countries, and the 24th highest percentage for the rest of the world. While the percentage of all adult Filipinos who borrowed from their employers seems to be low at 11.75%, this is still much higher than the regional average of 3.8%. Finally, Filipinos are most likely to borrow funds from family or friends, with almost half of the population borrowing from their close personal network in 2013.

Looking at borrowing behavior by income class, we can see that the poorest 40% of Filipinos prefer taking out loans from their employers (10.98%), private informal lenders (9.51%), *sari-sari* stores (16.92%), and family or friends (48.83%) over financial institutions (8.09%). The richest 60%, on the other hand, show almost the same behavior as their less affluent counterparts. Those in the top 60% income class prefer to borrow from private informal lenders (16.24%), stores through credit (16.14%), and family or friends (48.53%) over financial institutions (14.26%), and employers (12.25%) (Figure 6).

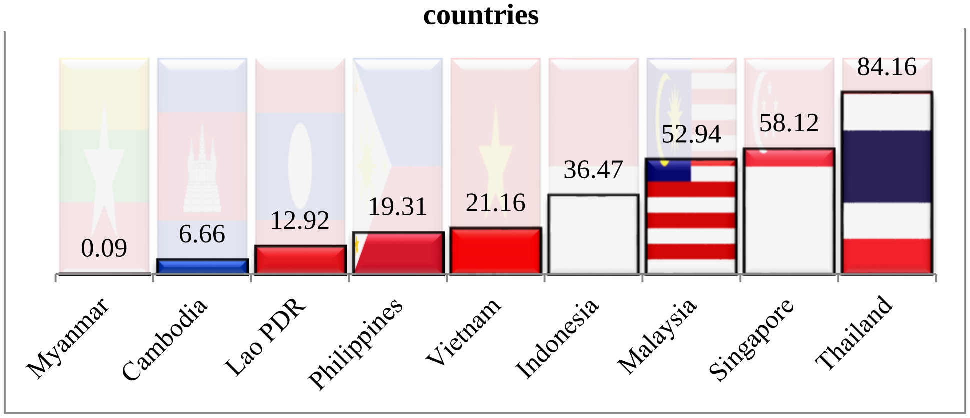
A possible reason for the Filipinos' preference for informal lenders over financial institutions is the high transactions costs and physical infrastructure to apply for loans with banks, and other formal credit institutions. The Philippines only has about eight commercial bank branches, and 19 automated teller machines per 100,000 adults. The number of commercial bank branches in the country is just equal to the regional average, and ten branches below the worldwide average. The number of automated teller machines in the Philippines, on the other hand, falls way behind both the regional average (32 ATMs), and worldwide average (46 ATMs).

Figure 7. Commercial Bank Branches per 100,000 adults, ASEAN countries



Note: Figure shows most recent values (MRVs) provided by dataset.
Source: Demirguc-Kunt et al., 2015.

Figure 8. Automated Teller Machines (ATMs) per 100,000 adults, ASEAN countries



Note: Figure shows most recent values (MRVs) provided by dataset.
Source: Demirguc-Kunt et al., 2015.

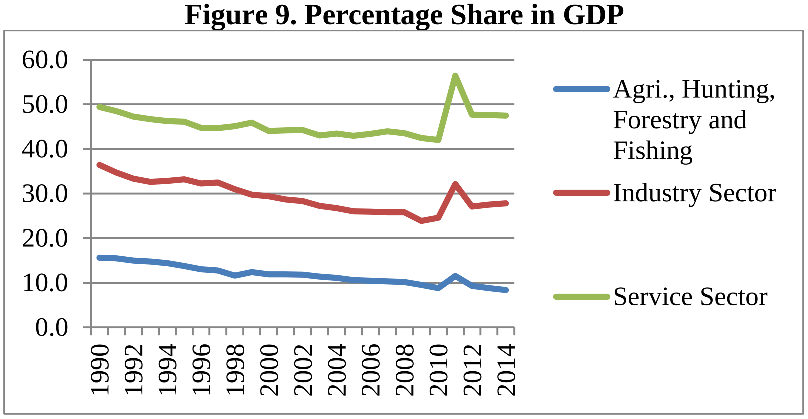
Moreover, there is a greater disparity if we look at credit access across regions. For instance, less than half of Mindanao has banking presence (48%), in comparison with NCR and the rest of Luzon's 100% and 75% banking presence, respectively. Further, four regions have less than 40% banking presence, as 2013 BSP data shows. These regions are the Cordillera

Administrative Region (33.8%), Eastern Visayas (27.3%), Zamboanga Peninsula (38.9%), and Autonomous Region of Muslim Mindanao (8.5%). Coincidentally, three of these regions belong to the six regions experiencing the highest poverty incidence in 2012, with ARMM (55.8%), Eastern Visayas (45.2%), and Zamboanga Peninsula (40.1%) coming in at 1st, 2nd, and 6th place, respectively. All three poverty rates are well above the national estimate of 25.2%. Clearly, the environment for credit access is still far from conducive to broad-based access by more firms and individuals.

Credit Upgrades and the Agriculture Sector

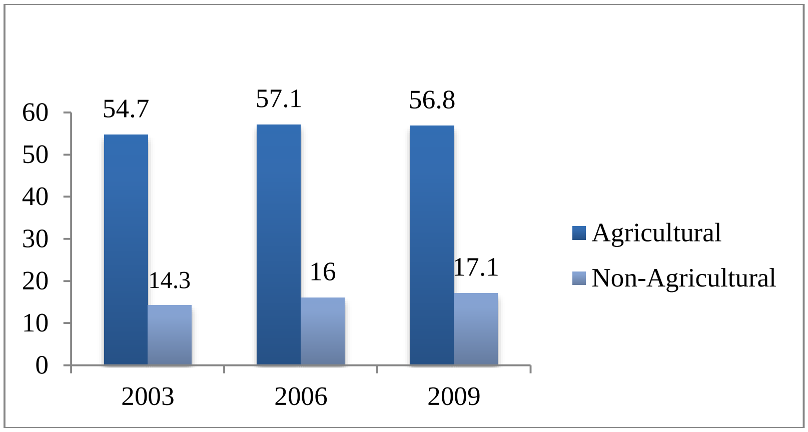
Further evidence from two aspects—the agricultural sector and small and medium scale enterprises (SMEs)—also indicates very tepid improvements, if any in credit access, despite this environment of plentiful credit. Recent evidence suggests that an agricultural household is three times more likely to experience poverty than a non-agricultural household (Reyes, et al. 2012, 23). The development of the agriculture sector is the key to inclusive growth. Two-thirds of poor workers are in agriculture, with 43% of agri-workers experiencing poverty (R. Briones 2015). In addition, the agriculture sector has consistently ranked last among the three main economic sectors in terms of GDP contribution. Philippine agriculture has also fallen victim to an unequal distribution of investments. Many farmers have difficulty in accessing credit, while necessary public investments in the sector have yet to be fully realized.

Figure 9. Percentage Share in GDP



Source: Philippine Statistics Authority.

Figure 10. Poverty Incidence in Agricultural and Non-Agricultural Households



Source: Reyes et al (2012); Philippine Statistics Authority.

Easier credit might help address the underdevelopment of the agricultural sector, notably if more projects and investments help to boost farm productivity. As regards to the latter, the benefits could be wide-reaching if, among other features, the credit is directed at key sectors that could have high "inclusiveness" for small and medium scale enterprises (accounting for the vast majority of firms in the Philippines (around 90%), and the greater majority of workers, around 65%) and for sectors where the bulk of the poor and low income families are engaged (e.g. the agricultural sector) (DTI, 2014; Briones, 2015).

Outstanding loans to the agricultural sector have been highly erratic since 1999, with the highest increase being 150.24% in 2008, and highest decrease at 45.61% in 2011 (Bangko Sentral ng Pilipinas, 2014). Just like in 2011, agricultural loans fell by 10.84% in 2012 despite 2011-2012 being the period where the country experienced two credit upgrades by Moody's. In 2013, after another credit upgrade, the Philippines' agricultural loans only increased by a modest 3.91% (BSP, 2014). Compare that to the increase in loans to the construction, and other sectors (e.g. fishing, mining and quarrying, manufacturing, electricity, gas, & water supply, wholesale, retail, and trade, hotel and restaurants, real estate, renting, and business activities, education, and health & social work) which ratcheted upwards that year by 47.4%, and 24.9%, respectively (BSP, 2014).

Micro-Lending

Policies have nevertheless been directed to increasing the agricultural sector's access to loans. For instance, in 2010, micro-agri loans were introduced by the BSP "to address the financing needs of small farmers, especially the microfinance borrowers engaged in farming that have other sources of non-farm income." Micro-agri loans can potentially increase the small farmer's access to bank credit, in turn offering them the means to invest and increase their productivity. Available data not only shows that it has not consistently grown since 2011, but that only 32 banks disbursed this type of loan in the whole country for Q2 2014 (Table 1). The increase in the portfolio for the types of loans that are supposed to benefit the small agricultural borrowers is not comparable with the rapid increase in the loan portfolio going to other sectors in industry and the private sector.

Table 1. Microfinance to the Agriculture Sector

	Q1/'12	**Q2/'12**	**Q3/'12**	**Q4/'12**	**Q1/'13**	**Q2/'13**	**Q3/'13**	**Q4/'13**	**Q1/'14**	**Q2/'14**	**Q3/'14**
Micro-Agri Loans (Millions PHP)	473.7	532	583.9	496.2	478.6	307	316.6	295.2	282	280	290
Banks offering Micro-Agri Loans	-	-	-	-	35	35	35	35	32	32	32

Source: Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff.

Microfinance lending also allows small private borrowers to access credit, and this could also be a channel towards more "inclusive finance" resulting from the credit upgrades. Through microfinance, growth in the greater financial sector should be able to reach smaller segments of the population. In 2012, 57.69% of the employed population were engaged with the small and medium scale enterprises (SMEs) (DTI, 2014). By increasing lending to SMEs, we might be able to increase investments in smaller firms and their employment generation prospects, in turn directly benefiting the majority of our workers. Nevertheless, growth in total eligible investments to micro and small scale enterprises, and medium enterprises since 2009 has only averaged around 2.68% and 9.49% respectively. Lending to these groups has not been stable, particularly since 2010, displaying alternately increasing and decreasing patterns, as shown in Tables 2 and 3.

Table 2. Total eligible investment for MSMEs (in Billions of Pesos)

	2009	2010	2011	2012	2013
Micro and Small Enterprises	167.65	159.11	168.39	186.19	185.09
Medium Enterprises	141.71	149.44	174.73	201.49	201.99
MSME	309.36	308.55	343.12	387.68	387.08

Source: Bangko Sentral ng Pilipinas.

Table 3. Snapshot of Microfinance in the Philippines

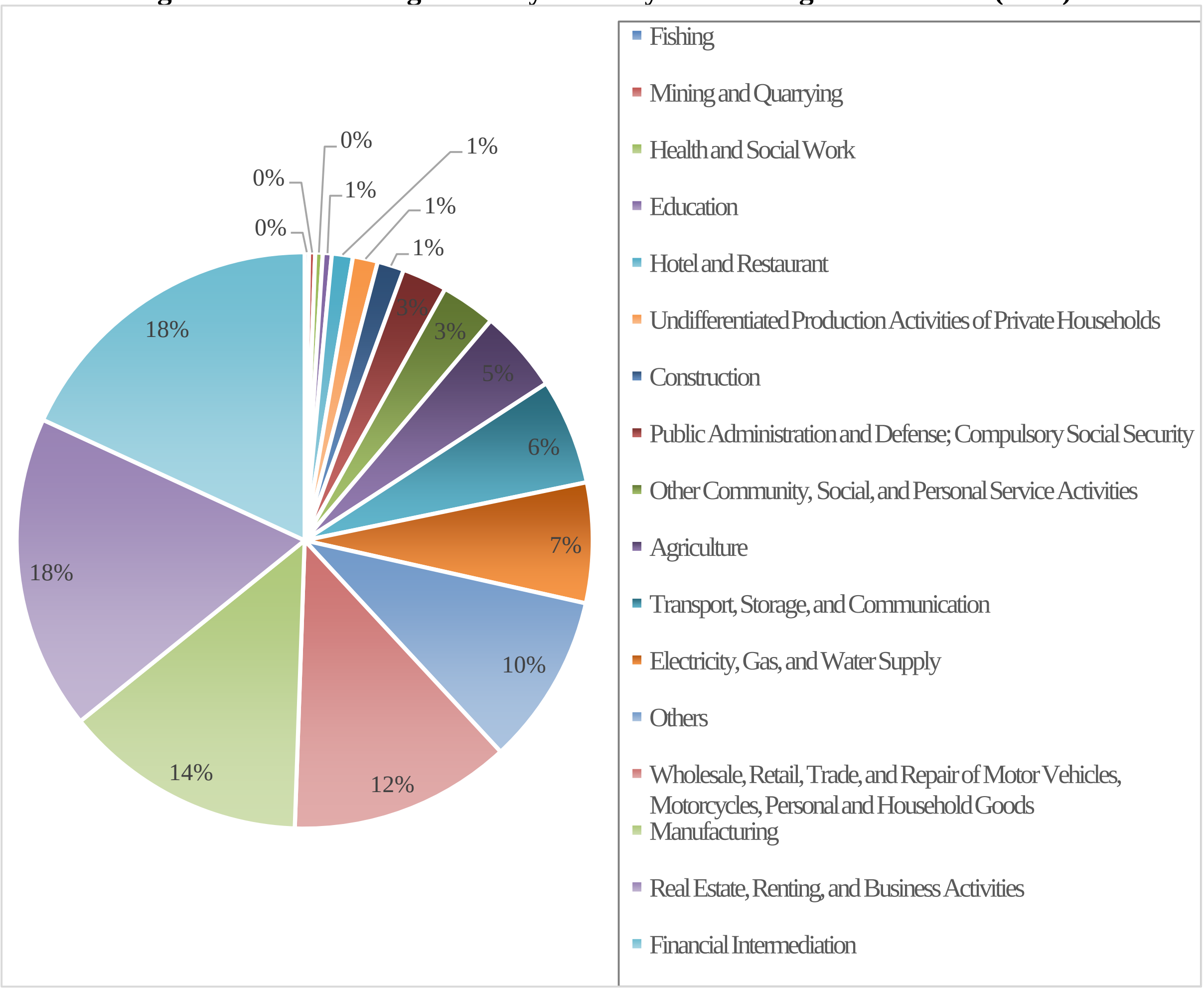
	'02	'03	'04	'05	'06	'07	'08	'09	'10	'11	'12	'13	'14
No. of Banks with Microfinance Operations	119	-	-	195	205	229	203	214	202	198	187	182	-
No. of Microfinance Banks	-	3	3	16	13	14	19	27	27	27	28	29	-
Microfinance Borrowers ('1000)	390	-	-	572	631	779	802	894	933	964	1,138	1,113	1,155
Microfinance Loans (in Bil. Php)	2.60	2.96	3.32	3.48	4.52	5.68	6.38	6.68	6.90	7.21	8.41	8.70	-
Loans to SMEs (in Bil. Php)	-	-	-	-	-	-	-	167.65	159.11	168.39	186.19	185.09	-

Source: BSP Inclusive Finance Advocacy Staff.

3. Credit Biased Towards Larger Firms and the Commercial Sector

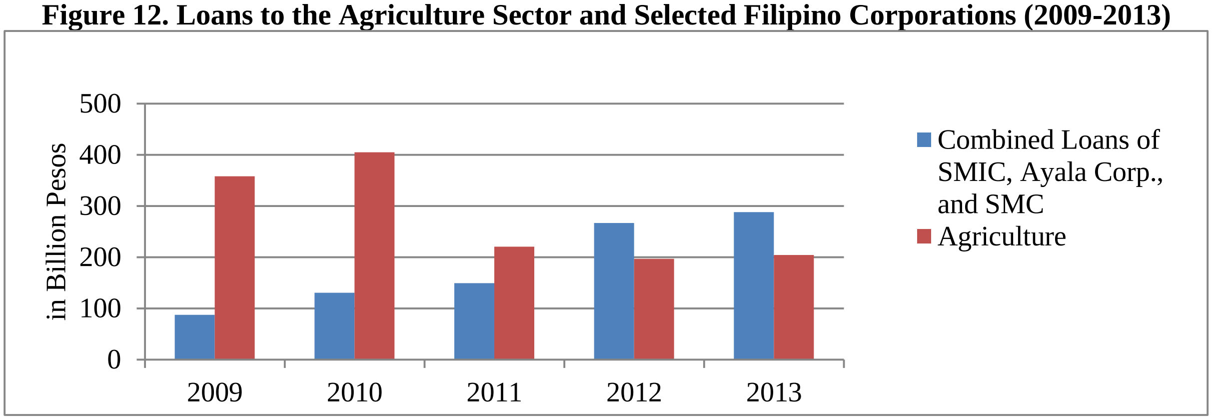
The BSP data from 2012 shows that Agriculture only accounted for 4.65% of the total Philippine loan portfolio (Figure 11). This places Agriculture 8th out of 17 industries, behind Real Estate, Renting and Business Activities (2nd) and Financial Intermediation (1st). Primarily large enterprises seem to be successfully cornering the lion's share of the benefits from the credit upgrades.

Figure 11. Outstanding Loans by Industry – Percentage Distribution (2012)



Source: Bangko Sentral ng Pilipinas.

Figure 12. Loans to the Agriculture Sector and Selected Filipino Corporations (2009-2013)



Sources: Authors' calculations based on data from BSP and SMC, SMIC, and Ayala Corporation 2010-2013 Annual Reports.

Three of the country's biggest conglomerates, SM Investments Corporation[7], Ayala Corporation[8], and San Miguel Corporation[9] are among those larger firms successfully tapping the financial markets. The combined bank loans of these three firms from years 2011-2013 are about 113% of total outstanding loans to the country's agriculture sector during the same period[10]. The amount of bank loans these three corporations received back in 2013 is more than triple the micro-agri loans issued to small farmers for the same year (Figure 12). In 2010, a year after the credit upgrade, total combined bank loans for the three corporations surged to PhP 130.33 billion from PhP 87.13 billion the previous year. That's a 49.58 percent increase in loans. For the same year, agricultural loans only increased by 13 percent (BSP, 2014).

Furthermore, just in 2014, the Lucio Tan group borrowed upwards of $850 million (P37.578 billion) from a syndicate of banks to finance its reacquisition of Philippine Airlines (Francisco 2014). That's almost a fifth of the 2013 outstanding loans to the agriculture sector and centuple the amount of 2014 micro-agri loans. Suppose farmers only take out micro-agri loans of P75,000 (half of the maximum), a 37 billion peso loan, the same amount as Tan group's multi-bank loan, could have benefitted 500,000 small farmers. This would easily be ten percent of the country's total farmers, forestry workers, and fishermen.

Moreover, in 2014, Ayala Corporation unveiled plans to borrow $1.6 billion (P70.927 billion) to fund two major coal power plants in Luzon, and Mindanao (Rivera 2014). This move will help Ayala Corporation exceed its 1,000 megawatt target for 2018.

Real estate corporations, similar to SMIC subsidiary SM Development Corporation (SMDC), have also greatly benefitted from the more accommodating credit environment. For instance, mass housing builder 8990 Holdings was reported to be raising PhP 9 billion through issuance of debt papers (Dela Peña, 2015). In August 2014, Century Properties was cleared to sell P3 billion worth of notes to partly finance capital expenditures of over PhP12 billion for the development of the Boracay and Bahamas towers at Azure Residences; Roxas West, Quirino West and Quezon South at the Residences at Commonwealth in Quezon City; and Century Spire at

[7] SMIC bank loans (in billions of Pesos) for years 2011, 2012, and 2013 as disclosed in its Annual Reports were 25.75, 31.80, and 27.59, respectively.

[8] AC bank loans (in billions of Pesos) for years 2011, 2012, and 2013 as disclosed in its Annual Reports were 41.08, 91.88, and 109.40 respectively.

[9] SMC bank loans (in billions of Pesos) for years 2011, 2012, and 2013 as disclosed in its Annual Reports were 82.59, 143.23, and 151.10 respectively.

[10] Outstanding loans to the Agriculture sector for years 2011, 2012, and 2013 as reported by the BSP were 220.41, 196.51, and 204.19, respectively.

Century City in Makati (Montealegre, 2014). Perhaps it is not surprising that the credit upgrades have ushered a very robust building boom in recent years, prompting some concerns that there might be a real estate bubble brewing.

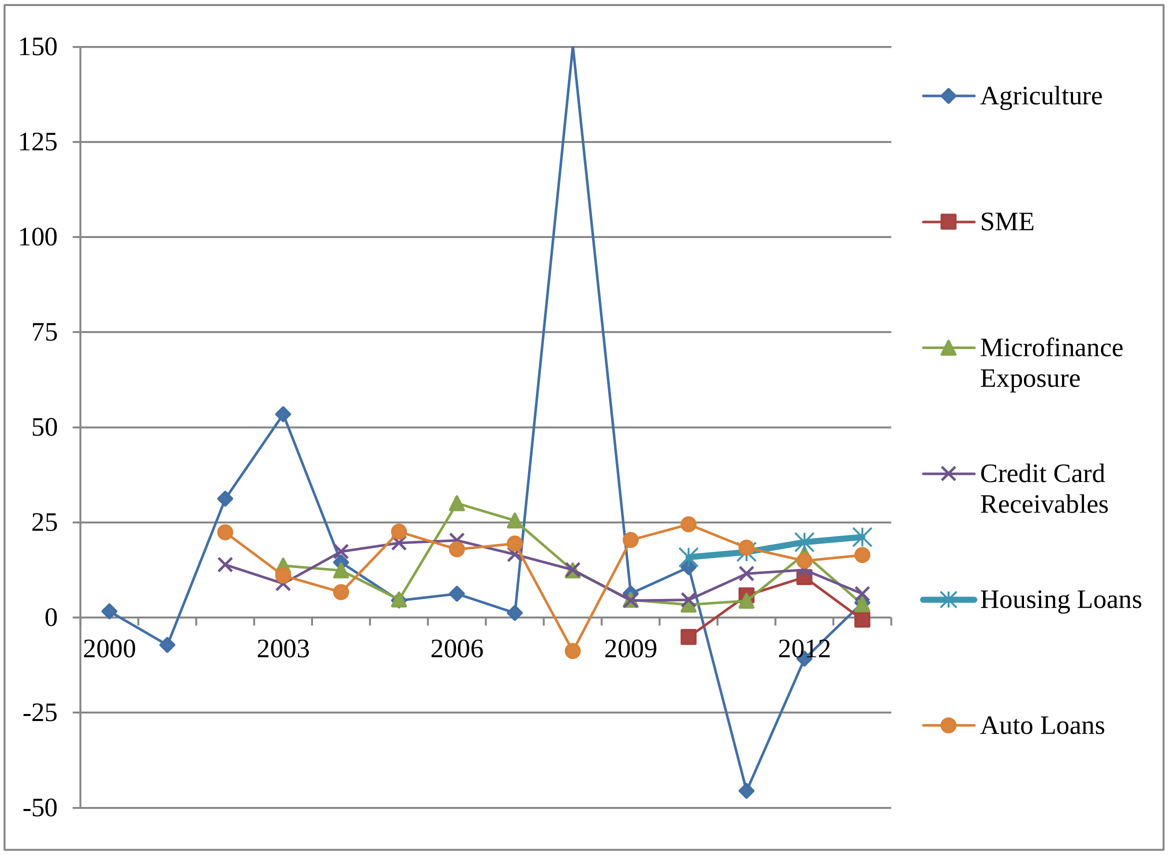
Both the World Bank (2014, 30-31) and the IMF (2014, 46) have warned the country of potential risks brought about by the rapid credit growth in the real estate sector, the growing size of shadow banking and reallocation of investments from special deposit accounts (SDAs) into real estate. According to the IMF, the Philippines has a medium risk of a domestic asset price bubble fuelled by abundant liquidity, due in part to the rapid capital inflow to the real estate sector.

There are currently concerns regarding the supply in the real estate sector. It was noted that the number of condominium units in the pipeline is far larger than the average number of units constructed in the last decade. Forms of shadow banking (World Bank 2014, 30-31), like in-house financing offered by real estate developers, comprise more than a third of the Philippines' total financial assets. Analysts consider this rather large in comparison to other developing countries, making it a possible source of risk to financial stability (World Bank 2014, 32). The money exiting SDAs could further intensify speculative growth in real estate, which, along with the inevitable rise in interest rates due to the end of quantitative easing, could increase the probability of defaults.

Commercial Loans

While the increase in agricultural loans and microfinance lending has been small and erratic over the years, commercial loans have consistently risen since 2009. Consumer loans have had an average growth of 14.96% for the past. five years, as compared to -6.61% for agricultural loans (Figure 13) As seen in the figure below, consumer loans have experienced relatively consistent growth, while agricultural loans displayed highly erratic growth. It is worth nothing that the growth in auto loans and credit card receivables has been incremental since 2008, averaging about 20% and 9%, respectively (BSP, 2014).

Figure 13. Growth Rate of Selected Loans in the Philippines



Source: Bangko Sentral ng Pilipinas.

4. Policy Options for Enhanced Financial and Economic Inclusiveness

The recent credit upgrades have given the country a more favourable investment climate, and more opportunities to maximize its debt. The Philippines could utilize its borrowing advantage to facilitate more inclusive growth in the economy. Facilitating broad-based benefits from the credit upgrades will likely require a combination of reforms, beginning with infrastructure spending, structural transformation in the agricultural sector and significantly reinvigorated micro-credit and lending.

Infrastructure Spending

In its Philippine Development Plan for 2011-2016, the National Economic Development Authority (2011, 22) stressed the need for a "massive investment in physical infrastructure." The poor and inadequate infrastructure and transportation system in the country have been cited by the ADB as impediments to investment and growth. The Philippines ranks 91st among 144 countries when it comes to quality of infrastructure, just 7 spots above its ranking five years ago. This places the Philippines behind five of its ASEAN counterparts, namely, Indonesia (56^{th}), Malaysia (25^{th}), Singapore (2^{nd}), Thailand (48^{th}), and Vietnam (81^{st}) in the Infrastructure sub-index of the World Competitiveness Rankings.

Quality infrastructure and an efficient transport system allow those in far-flung communities to not only engage in more businesses, but also gain better access to services in education, health and also finance. Therefore, the very means for inclusiveness in the market economy could lie in these road and transport systems that could better connect the entire population. Infrastructure spending also addresses issues in microfinance and agriculture in the country. Those in agriculture are not able to optimize the competitiveness of their goods due to the high logistics and transport costs and inadequate transport infrastructure in the country. Well-paved roads could dramatically enhance farmers' access to markets.

Farmers and small borrowers alike could benefit from improved physical infrastructure as this encourages more financial institutions to extend their services to those in agriculture-based communities. High risks and transaction costs, partly due to poor physical infrastructure, disincentivize microfinance institutions from reaching out to far-flung areas with almost no access to credit (Habaradas and Umali 2013, 13). On the top of the list of regions needing better infrastructure are the ARMM, CAR, Eastern Visayas, and the Zamboanga Peninsula, which have, as previously mentioned, the lowest banking presence in the country.

Structural Transformation in Agriculture

Because majority of poor workers in the country are in agriculture, giving attention to agriculture development is important for inclusive growth. Agriculture in the Philippines today is characterized by low productivity and is focused on low-value crops with no comparative advantage. Briones and Galang (2013, 1-2) suggest that a structural transformation in agriculture is needed. This involves a switch from *farming* to *agribusiness*, assisted by improved infrastructure, property rights, credit access, R&D, and government support.

By moving towards agribusiness, farmers could become more inclined to produce high-value crops. Also known as agriculture diversification, this requires a shift in production to cater to the changing demand patterns for more expensive food like meat, fish, poultry, and vegetables. Briones et al. (3) argue that the Philippines has a unique agriculture sector because it strays from the diversification strategy. In fact, despite the decrease in cereal share in developing Asian countries (from 40% to 24%), the Philippine share of cereals rose to 23% from 22%. Farmers can earn much more profit by switching from traditional crops such as rice and corn to high-value crops such as fruits and vegetables. This strategy also offers potential for employment opportunities due to its higher labor costs.

Innovation in farming technology is also essential to agriculture. According to Briones et al. (4), "Agriculture innovation is a public good that requires investments in research and development (R&D) and extension activities." However, in the past few years, there has been inadequate support for both low-value commodities such as rice, coconut, & sugarcane and high-value commodities such as fruits & vegetables. On the other hand, there has been a surplus allocation for dairy, goats and sheep, and carabao/beef. There has also been a lack of institutions dedicated to R&D of high-value and commercial crops such as rubber. There is no dedicated rubber research institute in the Philippines; there is a shortage of scientists specializing in rubber-related agronomy; and the crop is often overlooked in the extension system. Innovating on agriculture technology and reallocating support to more profitable crops can make the sector more competitive.

Farmers also suffer from insufficient support from the government. Small farmers lack access to technologies, technical understanding, quality inputs, and as mentioned earlier on, lack access to financing. Many farmers have limited access to formal financing not just due to their location but also due to their lack of collateral or to the high transaction costs involved. All these factors conspire to keep the majority of Philippine farmers trapped in lower levels of productivity, and therefore less financially viable for most formal financial institutions. This can certainly be changed by unleashing the productivity potential of the agricultural sector.

Expanding Micro-lending

Finally, the Philippine microfinance environment is regarded as one of the best in the world. The BSP has been proactive in delivering yearly initiatives for financial inclusion in the country. Having said that, there is still a long way to go in terms of creating a financially inclusive country.

The Bangko Sentral ng Pilipinas set up an office dedicated to financial inclusivity, called the Inclusive Finance Advocacy Staff.[11] In 2014, the Global Economic Intelligence Unit ranked

[11] See Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff (2014) for other financial inclusion initiatives by the BSP

the Philippines as having Asia’s most conducive environment for financial inclusiveness, placing third in a sample of 189 countries analyzed in its report (Economic Intelligence Unit, 2014, p. 31). The report indicated that it ranked high because of its financial inclusivity framework, policies, and documentation, but also noted that its weakness is in its implementation. In a nutshell, on paper it appears we have good policies—but in practice the country appears to display very modest inclusiveness when it comes to actual access to finance. Many factors could be behind this. Most MFIs are located in populous and urban areas, leaving behind more rural, and far-flung provinces like those in Mindanao. This prevents a lot of poor Filipinos from accessing micro-credit because of their location. Financial literacy is also still a problem in the country, with many Filipinos susceptible to engaging with deceptive informal financial institutions and faulty spending habits.

The growth in the microfinance sector in the country has been gradual. The number of microfinance banks in the Philippines in 2013 was 29; this is in comparison to the three microfinance banks in the country only a decade ago. In 2008, the country had 19 microfinance banks. This means that after five years of consistent credit upgrades, only ten banks dedicated to microfinance were built. Since 2002, the number of banks with microfinance operations has also grown, from 119 in 2002 to 183 in Q2 2014.

Nevertheless, microfinance lending and the number of microfinance borrowers have continually increased since the earliest available data in 2002. It is curious, however, that despite a double-digit (12%) growth in 2008, microfinance lending only received single digit growth in the years 2009-2011, and 2013—at precisely the period of the credit upgrades. The average annual growth in number of microfinance loans is at 11.93%. This is quite modest when compared to the average annual growth in consumer auto loans (22.14%) and housing loans (22 %).

The ADB has given support to the Philippine microfinance industry through its Microfinance Development Program (MDP), which allowed the government to tackle systemic issues in the microfinance sector. Among the recommendations of the ADB (2012) are:

1. *Continued promotion of financial literacy and consumer protection by the BSP, People’s Credit and Finance Corporation and microfinance network organization.* Outreach to households below the poverty line is still limited. Outreach to the poor must be improved through financial literacy education and expanding the microfinance network.

2. *Innovation and Adoption of Banking Technology.* Aside from improvements in physical infrastructure, attention may also be given to the banking technology in the country. Mobile banking and e-money can offer more opportunities to reach out to the poor.
3. *Vigilance in maintaining market-based principles for sound and sustainable microfinance operations.* The ADB reminds the Department of Finance – National Credit Council to continue to play a proactive role in preventing policy reversal that could threaten the market-oriented framework for microfinance.

In addition to these, Habaradas and Umali (2013) also recommended policy options for the improvement of microfinance access in the Philippines:

1. *A provision of performance standards and benchmarks for MFIs.* The BSP needs to build on its microfinance database to successfully monitor the progress and issues in strengthening financial inclusiveness in the Philippines. Moreover, it could set benchmarks to enable MFIs to re-evaluate and improve their operations to adopt best practices and systems.
2. *Expansion of MFIs' outreach to the poor.* Private and public sectors could provide increased support to strengthen the social performance of MFIs. An example would be the use of the Progress out of Poverty Index developed by the Grameen Foundation to measure the scope of poverty outreach.
3. *Increased involvement of various stakeholders in developing a sustainable and systematic microfinance program.* The government could look into more participation from different sectors such as the industry, and the academe in creating comprehensive program and providing technical assistance to MFIs in various areas, such as strategic planning, financial management, human resource management, and client targeting.

BIBLIOGRAPHY

Aldaba, Rafaelita M., 'The Philippine Manufacturing Industry Roadmap: Agenda for New Industrial Policy, High Productivity Jobs, and Inclusive Growth,' PIDS Discussion Paper Series No. 2014-32 (Philippine Institute for Development Studies: 2014)

Arsenio Balisacan, 'The Philippine Economy - Prospects and Outlook for 2015-2016', Presentation of Secretary Arsenio Balisacan at the 2015 FOCAP Prospects for the Philippines Forum, February 11, 2015, <http://www.neda.gov.ph/?p=4944>, accessed 25 February 2015.

Asian Development Bank, 'Philippines: Microfinance Development Program. Independent Evaluation', *Asian Development Bank,* (December 2012) <http://www.adb.org/sites/default/files/evaluation-document/36088/files/in14-13-0.pdf>, accessed 5 March 2015.

Asian Development Bank, 'Sector Assessment (Summary): Public Management – Investment Climate. Increasing Competitiveness for Inclusive Growth Program, Subprogram 2 (RRP PHI P43396)', *Asian Development Bank*, (2012) *<http://www.adb.org/sites/default/files/linked-documents/43396-013-phi-ssa.pdf>,* accessed 10 March 2015.

Ayala Corporation, *2010 Annual Report* (2010) <http://www.ayala.com.ph/uploads/pdfs/Annual%20Reports/AyalaAR_2010.pdf>, accessed 10 March 2015.

Ayala Corporation, *2011 Annual Report* (2011) <http://www.ayala.com.ph/uploads/pdfs/Annual%20Reports/AyalaAR2011.pdf>, accessed 10 March 2015.

Ayala Corporation, *2012 Annual Report* (2012) <http://www.ayala.com.ph/uploads/pdfs/Annual%20Reports/AyalaAR2012.pdf>, accessed 10 March 2015.

Ayala Corporation, *2013 Annual Report* (2013) <http://www.ayala.com.ph/uploads/pdfs/Annual%20Reports/0411_Ayala%20Annual%20Report%202013.pdf>, accessed 10 March 2015.

Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, '2011 Year End Report on BSP Financial Inclusion Inititatives: Mainstreaming Financial Inclusion in the Philippines and

Globally' (2011)
<http://www.bsp.gov.ph/downloads/Publications/2011/microfinance_2011.pdf> , accessed 1 March 2015.

Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, 'Financial Inclusion Initiatives 2014' (2014) <http://www.bsp.gov.ph/downloads/Publications/2014/microfinance_2014.pdf>, accessed 1 March 2015.

Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, 'Report on the State of Financial Inclusion' (2011) <https://www.google.com.ph/webhp?sourceid=chrome-instant&ion=1&espv=2&ie=UTF-8#q=Report+on+the+State+of+Financial+Inclusion+2011>, accessed 1 March 2015.

Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, 'Report on the State of Financial Inclusion in the Philippines' (2012) <http://www.bsp.gov.ph/downloads/Publications/2012/Financial%20Inclusion.pdf>, accessed 1 March 2015.

Bangko Sentral ng Pilipinas Inclusive Finance Advocay Staff, 'Report on the State of Financial Inclusion in the Philippines' (2013) <http://www.bsp.gov.ph/downloads/Publications/2013/Financial%20Inclusion.pdf> , accessed 1 March 2015

Bangko Sentral ng Pilipinas, 'Consumer Loans (2010-2013)' (2013) <http://www.bsp.gov.ph/banking/bspsup.asp>, accessed 10 February 2015.

Bangko Sentral ng Pilipinas, 'Micro, Small, and Medium Enterprises (2010-2014)' (2014), <http://www.bsp.gov.ph/banking/pbs_excel/70.xls>, accessed 10 February 2015.

Bangko Sentral ng Pilipinas, 'Outstanding Loans by Economic Activity' (2014) <http://www.bsp.gov.ph/statistics/excel/kbloans.xls>, accessed 10 February 2015.

Briones, Roehlano M., , and Ivory Myka R. Galang, 'Urgent: A road map for agro-industrial development in the Philippines,' PIDS Policy Notes No. 2013-06 (Philippine Institute for Development Studies: 2013)

Briones, Roehlano, 'Agriculture & structural transformation', Presentation at The Last Mile: Sustaining and Accelerating Poverty Reduction in the Philippines, March 6, 2015.

Danessa Rivera, ‘Ayala Corp. to Borrow $1.6B for Luzon, Mindanao Coal-fired Power Plants’ *GMA News Online*, 17 November 2014, <http://www.gmanetwork.com/news/story/388431/economy/companies/ayala-corp-to-borrow-1-6b-for-luzon-mindanao-coal-fired-power-plants>, accessed 25 February 2015.

Demirguc-Kunt, Asli, and Leora Klapper, ‘All About Finance - The 2014 Global Findex’, *The World Bank* [blog], (26 March 2015) <https://blogs.worldbank.org/allaboutfinance/2014-global-findex>, accessed 3 April 2015.

Demirguc-Kunt, Asli, Leora Klapper, Dorothe Singer, and Peter Van Oudheusden, ‘*The Global Findex Database 2014: Measuring Financial Inclusion around the World*’ (2015) Policy Research Working Paper Series No. 7255, (The World Bank: 2015)

Department of Trade and Industry, ‘MSME STATISTICS’ (2014) <http://www.dti.gov.ph/dti/index.php/msme/msme-statistics>, accessed 25 February 2015.

Economic Intelligence Unit, *Global Microscope 2014: The enabling environment for financial inclusion* (2014) <http://www.citi.com/latinamerica/en/community/data/2014_Global_Microscope-EN.pdf>, accessed 3 March 2015.

Global Credit Research, ‘Rating Action: Moody's upgrades Philippines to Baa2, outlook stable’, *Moody’s* (11 December 2014) <https://www.moodys.com/research/Moodys-upgrades-Philippines-to-Baa2-outlook-stable--PR_314504>, accessed 25 February 2015.

Habaradas, Raymund B., and Mar Andriel Umali, ‘The microfinance industry in the Philippines: Striving for financial inclusion in the midst of growth’,CBRD Working Paper 2013-05 (Center for Business Research & Development: 2013)

International Monetary Fund, *Philippines - 2014 Article IV Consultation - Staff Report; Press Release IMF Country Report 14/245* (2014), <https://www.imf.org/external/pubs/ft/scr/2014/cr14245.pdf>, accessed 1 March 2015.

Krista Angela Montealegre, ‘Regulators Clear Century Properties' Debt Sale’, *InterAksyon.Com*, 15August 2014, para. 1-4 <http://www.interaksyon.com/business/93362/regulators-clear-century-properties-debt-fund-raising>, accessed 25 February 2015.

Mynard Bryan Mojica - Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, ‘Data Requeest for Microfinance Loans’, [e-mail to Mynard Mojica], 16 March 2015, para. 1-2.

Mynard Bryan Mojica - Bangko Sentral ng Pilipinas Inclusive Finance Advocacy Staff, ‘microfinance loans - banking system’ [e-mail to Mynard Mojica], 18 February 2015, para. 1-2.

National Economic Development Authority, *In Pursuit of Inclusive Growth: The Philippine Development Plan 2011-2016* (2011) <http://www.neda.gov.ph/wp-content/uploads/2013/09/CHAPTER-1.pdf>, accessed 25 March 2015.

Norio Usui, *Taking the Right Road to Inclusive Growth: Industrial Upgrading and Diversification in the Philippines* (Mandaluyong: Asian Development Bank, 2012).

Philippine Statistics Authority, *Annual Labor and Employment Estimates for 2014*, accessed 20 April 2015.

Philippine Statistics Authority, *Gross Domestic Product, by Industrial Origin: Percentage Distribution*, accessed 20 February 2015.

Reyes, Celia M.,Aubrey D. Tabuga, Ronina D. Asis, and Maria Blesila G. Datu, ‘Poverty and agriculture in the Philippines: trends in income poverty and distribution’ PIDS Discussion Paper Series No. 2012-09 (Philippine Institute for Development Studies: 2012)

Rosemarie Francisco, ‘San Miguel Signs $1-B Deal to Sell PAL Stake Back to Lucio Tan Group – Source’, *GMA News Online,* 8 September 2014, para. 9, <http://www.gmanetwork.com/news/story/378274/economy/companies/san-miguel-signs-1-b-deal-to-sell-pal-stake-back-to-lucio-tan-group-source>, accessed February 25, 2015.

San Miguel Corporation, 2010 Annual Report (2010) <http://www.sanmiguel.com.ph/PDF/CMS_AR_PDF/2010_SMC_ANNUAL_REPORT.pdf>, accessed 10 March 2015.

San Miguel Corporation, 2011 Annual Report (2011) <http://www.sanmiguel.com.ph/PDF/CMS_AR_PDF/2012_SMC_ANNUAL_REPORT.pdf>, accessed 10 March 2015.

San Miguel Corporation, 2012 Annual Report (2012) <http://www.sanmiguel.com.ph/PDF/CMS_AR_PDF/2012_SMC_ANNUAL_REPORT.pdf>, accessed 10 March 2015.

San Miguel Corporation, 2013 Annual Report (2013) <http://www.sanmiguel.com.ph/PDF/CMS_AR_PDF/SMC_AR2013_web.pdf>, accessed 10 March 2015.

Serafica, Ramonette B., 'Formulating the Philippine Services Strategy for Inclusive Growth (2014),' PIDS Discussion Paper Series No. 2014-22 (Philippine Instittute of Development Studies: 2014)

SM Investments Corporation, 2010 Annual Report. SEC Form 17-A (2010) <http://www.sminvestments.com/sites/default/files/reports/SMIC%20SEC%2017-A%20December%2031%2C%202010.pdf>, accessed 1 March 2015.

SM Investments Corporation, 2011 Annual Report. SEC Form 17-A (2011) <http://www.sminvestments.com/sites/default/files/reports/SEC%2017-A%20December%2031,%202011.pdf>, accessed 1 March 2015.

SM Investments Corporation, 2012 Annual Report. SEC Form 17-A (2012) <http://www.sminvestments.com/sites/default/files/reports/SMIC%20SEC%2017-A%20December%2031,%202012.pdf>, accessed 1 March 2015.

SM Investments Corporation. 2013 Annual Report. SEC Form 17-A (2013) <http://sminvestments.com/sites/default/files/reports/SEC%2017-A%20December%2031,%202013.pdf>, accessed 1 March 2015.

United Nations Development Programme, 'About the MDGs', *UN Millenium Project*, (2001) <http://www.unmillenniumproject.org/goals/>, accessed 15 March 2015.

World Bank, '*Ranking of Economies'- Doing Business* (2015) <http://www.doingbusiness.org/rankings>, accessed 25 February 2015.

World Bank, Pursuing *Inclusive Growth through Sustainable Reconstruction and Job Creation. Philippine Economic Update Report No. 83315-PH* (2014) <http://www.worldbank.org/content/dam/Worldbank/document/EAP/Philippines/Philippine%20Economic%20Update%20March%202014.pdf>, accessed 20 March 2015.

World Economic Forum, *The Global Competitiveness Index Historical Dataset (2005-2014),* accessed 20 April 2015.

Zinnia Dela Peña., '8990 Holdings Eyes P9B from Notes Issue', *The Philippine Star*, 18 February 2015, para. 1-11,

<http://www.philstar.com/business/2015/02/18/1424858/8990-holdings-eyes-p9b-notes-issue>, accessed February 25, 2015.

+AMDG

This policy research is in collaboration with Konrad-Adenauer-Stiftung.