Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar

ROGER THOMAS MOYES
KENNETH SHWEDEL

MAY 1, 2017
YANGON, MYANMAR
The views expressed in this report are those of the authors and do not necessarily reflect the views and policies of the Government of Australia, or of the Asian Development Bank (ADB) and its Board of Governors and the governments represented by ADB.

ADB and the Government of Australia do not guarantee the accuracy of the data in this report and accept no responsibility for any consequence of their use. The mention of specific companies or products of manufacturers does not imply that they are endorsed or recommended by ADB or the Government of Australia in preference to others of a similar nature that are not mentioned.

By making any designation of, or reference to, a particular territory or geographic area, or by using the term “country” in this document, ADB and the Government of Australia do not intend to make any judgments about the legal or other status of any territory or area.
# Contents

About the Authors......................................................................................................................... i
Acknowledgements........................................................................................................................ ii
Executive Summary............................................................................................................................ iii
Introduction........................................................................................................................................ 1
Background......................................................................................................................................... 1
Regulatory Environment – Myth vs. Reality..................................................................................... 4
Conclusions and Recommendations: Aligning Financial Regulation with the Need for Financial Inclusion................................................................................................................................. 9
References .......................................................................................................................................... 15
About the Authors

Roger Thomas Moyes

Roger Thomas “Tom” Moyes joined the Mekong Business Initiative in 2015, and now serves as project manager in charge of MBI’s access to finance-related initiatives. Before joining MBI, he was senior technical advisor to the World Bank’s Agricultural Finance Support Facility—the AgriFin Program. The AgriFin Program was focused on expanding the supply of commercial financing for agriculture and developing a network of commercial agricultural bankers to identify and share best practices. Before AgriFin, Tom was posted to Indonesia as the International Finance Corporation’s (IFC) Access to Finance program manager. While in Indonesia, Tom designed an agricultural value chain financing project involving a commercial bank, a large off-taker, and smallholder farmers in the cacao value chain—the first project of its kind for IFC in Asia. He has also served as rural financial market specialist for the Asian Development Bank, and is the author of several recent publications on rural and agricultural finance. Tom started his professional career as a bank lending officer, working in New York and Los Angeles for Swiss Bank Corporation (now UBS).

Kenneth Shwedel

Kenneth “Ken” Shwedel has enjoyed an extensive career in agriculture and banking. He served as executive director at Rabobank International in Mexico City. Before his time at Rabobank, Ken headed the American Soybean Association’s office for Mexico, Central American, and Caribbean Basin. Ken also spent 10 years at Banco Nacional de Mexico, rising to become vice president and senior economist, focused on the agricultural sector. Ken now dedicates much of his time to serving on a number of boards of directors for companies related to agribusiness and agricultural finance. He also sits on the board of directors of the Mexican Rural Development Foundation. Ken has participated in a number of working groups involved in developing agricultural policy in Mexico, and was responsible for establishing the agriculture value chain policy for the Government of Mexico. Ken recently advised the World Bank’s AgriFin Program on the design of their commercial banking “boot camp” program for agricultural lenders. He holds a Ph.D. in Agricultural Economics from Michigan State University.
Acknowledgements

This paper was initially conceived as a four to five page “brief” but grew well beyond that as the authors happened upon new and different angles to the story. It is not meant to be a definitive study on agricultural finance in Myanmar. Rather, it is a snapshot of the current state of regulations that impact the financing of agriculture, and a brief catalogue of the most pressing issues that policy makers and regulators need to consider as they build a modern financial system that suits Myanmar’s agricultural economy.

We are grateful for the support and inspiration provided by Dominic Mellor and Peter Brimble, the two senior Asian Development Bank (ADB) staff who together conceived and launched the Mekong Business Initiative (MBI) in 2014. MBI is an advisory facility that promotes private sector development in Cambodia, the Lao People’s Democratic Republic (Lao PDR), Myanmar, and Vietnam. MBI fosters development of the innovation ecosystem by supporting business advocacy, alternative finance and innovation. It is supported by the Government of Australia and the Asian Development Bank. Through MBI the authors have been given free rein to work on agricultural finance in Myanmar, and we hope that this paper helps demonstrate the value of MBI’s work to promote more commercial financing of agriculture in Myanmar. We also hope to do more, and to build on this research and analysis.

It should be noted that the findings and recommendations expressed in this paper represent solely the opinions of the authors, and are not intended to represent policies or opinions of either ADB or Australia’s DFAT. Likewise, any errors of commission or omission are exclusively those of the authors.

The authors are particularly grateful for the inputs of our four peer reviewers, Dave Grace, Tocher Mitchell, Paul Luchtenburg and Sean Turnell, who gamely slogged through early drafts of the paper and provided many useful insights and corrections. In addition to the peer reviewers, Connor McGuinness of DFAT offered a number of sensible editorial suggestions. Ann Bishop proved a very engaged and energetic editor who deserves the reader’s gratitude for helping to make the paper much more understandable to that sizeable portion of humanity unused to reading about agricultural finance. Wickie Mercado provided the final elegant touches to the document, which allows us to place this into the public domain, and into your hands.

Roger Thomas Moyes
Kenneth Shwedel
Executive Summary

The Government of Myanmar has affirmed its commitment to modernizing banking and finance laws and regulations, and at the same time, to developing the country’s agricultural sector. To realize the latter objective, it will be necessary to encourage commercial banks to increase financing for agricultural enterprises. Although the Myanmar Agricultural Development Bank (MADB), credit cooperatives, and microfinance institutions (MFIs) are actively involved in rural and agricultural finance, commercial banks have been reluctant to directly finance agriculture. Current financial regulations are among the key obstacles to expanded lending to the agricultural sector by Myanmar’s banks.

Background

From 2014 to 2016, agriculture accounted for 26.3% of Myanmar’s GDP, but over the same period formal bank lending to the sector amounted to only 2.5% of total lending, or about US $295 million. Compare this figure with the US $4.6 billion estimated potential size of the agricultural credit market in Myanmar, and a massive “lending gap” becomes obvious. These figures demonstrate both the magnitude of the problem and the significant market opportunity in agricultural credit. With a loan-to-deposit ratio of about 55%, banks have significant resources that could—under the right circumstances—be lent to primary producers and agribusinesses.

Formal credit to farmers is largely provided from three sources: MADB, financial cooperatives, and MFIs. The latter two types of financial institutions (FIs) focus on loans to smallholders. Official lending figures, however, do not include any supplier or value chain financing volumes. Supplier financing is likely a multiple of the amount of formal credit flowing through Myanmar’s rural markets. Yet even including financing provided by input suppliers and other value chain actors, the total amount of agricultural credit is much less than what is required, especially when capital investment needs are also considered.

Overly strict regulation and tight supervision have been significant factors discouraging even the most basic working capital lending by banks to primary agricultural producers and agribusinesses. Underlying much of the reluctance to lend to agriculture is the lack of understanding or misperception of credit risks in agriculture, as well as the absence of appropriate loan generation and monitoring systems in rural areas. The 13% per annum (p.a.) cap on lending rates and high capital charges for opening branches in rural areas, among other regulations imposed by the Central Bank of Myanmar (CBM), puts pressure on banks’ financial margins. A common perception that serving the agricultural sector may be less profitable adds to the hesitance of bankers to invest in the development of the core competencies needed for successful agricultural lending. In addition, Myanmar also lacks the supporting institutions and agencies that facilitate agricultural finance, including market price reporting services, professional warehouse managers, crop insurance providers, etc. The result is that Myanmar’s commercial banks prefer—perhaps sensibly—to pursue the “easier” revenue-making opportunities in other sectors.

Regulatory Environment – Myth vs. Reality

There are oft-repeated myths and misperceptions about what banks can and cannot do when it comes agricultural finance. What banks are allowed to do legally is often at odds with commercial banks’ own standard operating procedures. Also, certain myths have persisted through constant repetition in conversations among bankers and in reporting on the banking sector by interested observers.
Much of the confusion results from the highly compartmentalized nature of the financial system, in which banks, MFIs, and cooperatives, along with the MADB, operate within legal and regulatory “silos.” The silo-like nature of the financial system results in confusion as to which set or sets of institutions are best placed to finance agriculture. Key areas of confusion include:

**Land as collateral vs unsecured lending**: Banking regulations do not prohibit unsecured lending, despite the claims of many reports, and of many bankers, to the contrary. Property other than real property can be used as collateral for loans. Bankers, however, report that when their banks engage in unsecured lending they are severely criticized by CBM regulators who “suggest” that they reconsider their unsecured lending, implying that they are taking undue risks.

**Loan size**: A few banks reported that they were limited by regulations in how much they could lend to farmers—namely a maximum of MMK 1,500,000. While this limit was set as a policy by MADB for its own lending, this policy does not apply to commercial banks. In the case of MFIs, their maximum loan amount is set at a low level (MMK 5 million) by their regulator, which prevents them from providing the amounts of credit that larger farmers, crop dealers, aggregators, and processors might require. They are thereby prevented from engaging in value chain financing arrangements.

**Interest rates**: CBM regulations set a ceiling on loan interest rates for banks, and are presently capped at 13% per annum (p.a.). MFIs, in contrast, can lend at up to 30% p.a. Cooperatives face no interest rate ceiling. In addition to a loan rate ceiling, banks also face a deposit rate floor of 8%, though some current accounts pay no interest. Banks must operate within a spread that is not much greater than 500 basis points. These bank margins are relatively small, pressuring profits, which in turn discourages lending to new market segments that might involve greater risks. As such, the CBM-imposed interest rate regime reinforces banks’—and the CBM’s implied—preference for making larger loans to more familiar urban clients that are closer and therefore easier to serve—and can offer preferred forms of collateral.

**Pricing risk**: Commercial banks argue that with a low loan interest rate ceiling they cannot effectively price risk. CBM supervisors consider the banks deficient in this area, with some justification. Banks, however, have begun to develop capacity for risk analysis and risk-based pricing. At the same time, it is reasonable to question whether CBM has the skill to effectively evaluate banks’ risk management capacity. Myanmar lacks reliable risk management information systems such as a credit bureau or price reporting mechanisms, among others. Under these circumstances, banks will likely continue to manage risk primarily through conservative lending practices, including demanding high collateral coverage.

**Loan tenor**: Presently, the maximum loan tenor rarely exceeds one year, which appears to be another common banking practice not mandated by law or regulation. Banks are legally permitted to roll over loans for up to three years. The short standard tenor means borrowers may be uncertain whether their loans will be rolled over after 12 months, which makes borrowing for capital investment an uncertain proposition. This system-wide practice results in loans being improperly structured as short-term working capital financings, when they should be medium- to long-term loans.
Conclusions and Recommendations: Aligning Financial Regulation with Financial Inclusion

Myanmar requires a financial system built to facilitate the financing of agriculture and to serve the needs of a large, dispersed rural population. Too much attention has been paid to drafting rules and regulations, like those that require banks to direct credit to the agriculture sector. Too much effort has gone into drawing distinctions between the different types of FIs—commercial banks vs. MFIs vs. credit cooperatives—which among other effects, creates barriers to competition between different categories of financial providers, competition that would be a benefit to consumers.

The recommendations below are provided to help re-align current and future regulations with the government’s policy objective of expanding financial access for farmers, agribusiness, and rural dwellers.

Capacity Building Is Imperative

Regulator skills sets: Awareness raising, as well as formal training programs for regulators and supervisory staff are essential for creating a strong and progressive regulatory environment for the financial sector. Sector-specific understanding and skill sets are especially important with regard to agriculture. Senior policymakers with oversight of financial regulators should also be included.

Risk management: CBM and Financial Regulatory Department (FRD) of the Ministry of Planning and Finance (MoPF) should consider the engagement of agriculture risk management experts with experience assessing bank risk management capacity. These experts should have experience in other developing countries, and should help CBM and FRD implement sensible rules and regulations to ensure effective risk management while not unnecessarily hindering profitable banking operations. Development partners could facilitate this assistance by providing resources to retain such experts.

Research and policy-making: CBM and FRD need to develop the capacity for in-house research to serve as the basis for policy development, as well as for staff education. As a suggestion, initial research should focus on analyzing the impact of interest rate restrictions on agricultural credit flows.

Regulatory and Supervisory Evolution

Collateral: The decision to make either secured or unsecured loans to clients should be left to a financial institution’s (FI) management, based on their appetite for risk and its ability to price risk appropriately. Furthermore, there should be no limits on the form of acceptable collateral, as this restricts the ability of FIs to expand financial outreach. CBM should move toward more rigorous, risk-weighted capital adequacy requirements. For regulators, this will necessitate significant additional training.

Interest rates: CBM’s interest rate ceiling strongly discourages banks that might otherwise provide loans to smallholders and medium-sized farm operators. Both interest rate floors and ceilings need to be removed. It is suggested that there be a transition period during which banks would be required to develop internal procedures for pricing risk. Deposit interest rate floors can be relaxed more quickly.

Loan tenor: Regulators also require new skill sets in order to understand whether banks are underwriting agricultural credit properly, e.g., setting loan tenors to coincide with crop cycles, matching fixed asset loan maturities to the useful life of an asset. Both bankers and regulators need urgent instruction in proper loan underwriting—including appropriate structuring—of agricultural loans.
Branch banking: Banks’ ability to extend their branch network into rural areas is hindered by the paid-in capital requirements for each new branch. The requirement for additional capital for setting up branches in rural areas should be eliminated.

Agency banking: The use of banking agents represents another opportunity to extend the reach of banks into the nation’s countryside. It is recommended to develop a licensing process that encourages agency banking. It is worth considering MFIs and financial cooperatives as potential banking agents.

The role of MFIs: MFI regulations should allow the option of operating as the financial agent of a bank, and not create barriers to MFIs’ moving upmarket to serve “emerging” farmers and small agribusinesses. In the latter case, a relaxation of the MFI loan size limit is recommended, which would facilitate more MFI lending to the agricultural sector.

Value chain financing: Commercial banks and MFIs should be encouraged to engage in value chain financing (VCF). Since this approach represents a departure from traditional lending practices, regulators need to develop an understanding of VCF concepts. It is particularly important that regulators appreciate VCF as a risk reduction strategy, and that VCF techniques should be considered when evaluating an MFI or commercial bank’s risk management capacities.

Facilitating Legal and Policy Changes and Supporting Institutions

Financial system de-compartmentalization: Having separate categories of financial institutions, each with its own set of regulations, works against financial inclusion and makes it difficult to develop agricultural value chain financing arrangements. To the extent possible the CBM and FRD should align regulations across all FIs; all should be encouraged to compete for agricultural clients energetically, and serve rural dwellers with a broad range of products—and be allowed to do so profitably. Myanmar needs to move away from an ad hoc, regulator-dominated approach to agricultural finance to one that is focused on outcomes, and driven by an overarching policy vision and consensus.

Special-Purpose Financial Institutions (SPFIs): The financial sector would benefit from FIs specialized in agriculture, ranging from banking agents, to warehouse receipt financing companies, to credit companies specializing in the sector. Specialized finance companies, with more skilled staff, are often better equipped than banks to manage the risk of agricultural lending. There needs to be a clearly articulated policy to promote SPFIs for agriculture.

Warehouse Receipts: The lack of a warehouse receipts law and accompanying regulatory provisions for warehouse receipts as a financial instrument hinders the development of inventory-based lending. The warehouse financing function should be supported by either a specific law, or specialized regulations that define the functioning of the system through clear roles and responsibilities.

Facilitating institutions: Myanmar needs, strong supporting institutions that help all sectors and types of businesses including agriculture. Notably lacking are a modern credit bureau as well as a secured transactions framework that supports the use of movable collateral. Additionally, to promote lending to agriculture, systems for tracking market price and cost data must be improved.
Introduction

Major efforts to reform Myanmar’s financial sector date back less than a decade, including the granting of licenses to private banks, and establishing the Central Bank of Myanmar (CBM) as an independent authority. The National League for Democracy (NLD), which assumed power in 2016, has reaffirmed the government’s commitment to modernize banking and finance regulations, beginning with passage of the Financial Institutions Law (FIL) in 2016.1 At the same time, the government has made developing the country’s agricultural sector a key policy initiative.2 However, in order to achieve the government’s goals, it will be necessary to increase commercial bank financing for the country’s farmers and agribusiness value chains.

Although the Myanmar Agricultural Development Bank (MADB), credit cooperatives, and microfinance institutions (MFIs) are providing some agricultural finance, commercial banks have been reluctant to provide credit to the sector. However, given the large gap between the amount of finance currently provided to Myanmar’s agricultural sector, and what is needed for the sector to become globally competitive, commercial banks will need to play a much bigger role.3 At present, though, it is fair to say that Myanmar’s regulatory environment is an important obstacle to greater lending in agriculture.

This report will highlight key financial regulations, and misconceptions about these regulations that impact—and in many cases hinder—the commercial financing of agriculture. The report will also identify the priority areas for policy and regulatory reform that would enable commercial banks, as well as other financial institutions (FIs), to profit from financing agriculture. In doing so, the authors hope that the findings and recommendations offered here will encourage commercial banks to target agricultural producers and agribusinesses as their primary clients.

Background

The NLD government’s economic policy puts strong emphasis on agriculture through its commitment to promote inclusive growth, increase exports, develop high value-added crops and livestock, and improve “production chain sectors”.4 This implies both the application of a value chain approach to sectoral development, and the need for significantly greater amounts of financing. This focus on agriculture reflects Myanmar’s economic reality as well as the government’s concern about increasing social development in rural areas. The country’s “economy remains highly dependent on agriculture to support production, employment, and foreign exchange revenue through exports.”5 However, according to the World Bank, “the agriculture sector is undercapitalized, reflecting decades of insufficient levels of investment, including in basic infrastructure such as roads, warehouses, electricity, irrigation systems,

---

1 The Financial Institutions Law, passed at the beginning of 2016, was designed to update banking law that dates back to 1990. Among other things, the law is meant to better align the financial system with Basel III requirements and lay the groundwork for a “more efficient and stable banking system,” as well as for the expansion of financial products, and the eventual operation of non-bank financial entities (San Thein. 2016. “Financial Institutions Law for a stable and modern banking system”).
2 The election manifesto of the NLD stated that developing the agriculture sector will be the first priority. (Kyaw Phone Kyaw. 2016. “The new government’s economic policy paralysis.”)
3 See Smit et al. 2015. “Myanmar Agricultural Finance: Summary Note.”
4 Aye Thidar Kyaw and Hammond. 2016. “Government reveals 12-point economic policy”.
research, sanitation centers, and extension services, among other infrastructure, resulting in low productivity in the sector and low rural incomes.”

Although numerous factors contribute to the lagging performance of Myanmar’s primary producers and agribusinesses, the lack of formal sources of capital, including credit, and a generally ineffective banking system, are major problems. Based on research conducted for this report, the potential for the agricultural credit market in Myanmar is an estimated US$4.6 billion. Considering that in 2014–2015, total lending in the country was 17.9% of GDP, and agricultural lending was around 2.5% of total lending, this implies that formal agricultural lending is only around US$295 million. Although these figures are, at best, estimates, and even if the size of the market has been overestimated and the total amount of finance provided by the formal financial sector has been underestimated, the lending gap is still very large. This also demonstrates the magnitude of the problem, as well as the significant potential market waiting for Myanmar’s formal financial sector.

Box 1: The Social Dimensions and Limitations of Myanmar’s Agricultural Sector

Of Myanmar’s approximately 54 million inhabitants, just over 60% live in rural areas and nearly 23 million adults live in households that are engaged in farming. Of the country’s total labor force—an estimated 35 to 40 million people—it is likely that at least half are engaged in some form of agricultural production. However, in 2014 agriculture generated only 26.3% of the country’s gross domestic product (GDP), and in 2012, the annual income per agricultural worker in Myanmar was only an estimated US$194—far lower than the average income for agricultural workers in Malaysia (US$6,680 dollars), and lower than the US$706 in Thailand.

Sources:

1 Anyone discussing Myanmar’s economy must recognize that accurate and timely data are not available. Population estimates, for example, range from 50 to 60 million (MSU and MDRI/CESD. 2013. A Strategic Agricultural Sector and Food Security Diagnostic for Myanmar). In 2015, the Department of Population of the Ministry of Immigration and Population listed the population at 53,897,000 (DP MIP. 2015. The 2014 Myanmar Population and Housing Census: The Union Report Census Report. Vol. 2).


7 The size of the market is based on estimates of agriculture’s 26.3% share of GDP (CIA. 2017. The World Factbook)—or about US$65.8 billion over 2014–2016—and assumes that: 1) the cost of production represents 50% of agriculture’s share of GDP; 2) 50% of the cost of production is from “creditworthy” farmers; and 3) financial institutions with agricultural lending experience would be willing to loan up to 60% of production costs. The coefficients are based on the authors’ experience with commercial banks’ practices in other regions. As such, readers should note that this is a very rough estimate, and offered as a starting point for discussions about demand for agricultural sector credit.

8 The World Bank Group’s Myanmar Enterprise Survey 2014 showed that access to finance was also the largest constraint faced by firms outside the agricultural sector (WBG. 2014. Enterprise Surveys – What Businesses Experience: Myanmar).
The figures quoted above, which refer to lending by licensed (ergo, “formal”) FIs, do not indicate the volume of supplier or value chain financing that is taking place in Myanmar. These data are very difficult to track even in developed economies, and not surprisingly in Myanmar, no estimate is available for the amount of supplier-based credit being provided to the agricultural sector.

Under the Mekong Business Initiative (MBI) of the Asian Development Bank (ADB), a team of experts—including the authors of this report—is helping a commercial bank to develop agricultural value chain financing products. The MBI team has looked closely at the maize value chain, and found that significant amounts of credit are being offered within the value chain—most of it in the form of inputs (seed and fertilizers), which are advanced to farmers prior to the planting season, with the loans repaid upon sale of their harvested crops. MBI estimates the annual “value” of products flowing through Myanmar’s maize value chain to be US$150–200 million, which is about 50–70% of the credit that formal FIs provided to the entire agricultural sector in 2014–2015. Very likely, similar informal forms of credit are provided in other agricultural value chains. It is reasonable to assume that the volume of supplier/value chain financing in Myanmar is a multiple of the credit that formal institutions provide to agriculture.

It should also be noted that FIs often underreport the credit they provide to the agricultural sector, or they do not report it as such. For example, banks, for their part, tend to report the loans they make to larger agribusinesses as either “commercial” or “corporate” credit, not as agricultural credit, per se. Likewise, the loans that MFIs and cooperatives provide to agricultural producers are not necessarily classified as agricultural production loans. Agricultural lending by a bank in Myanmar is often narrowly construed as lending for production only and, in addition, banks do not report on the sectoral composition of their loan portfolios. These factors combine to make estimating the amount of agricultural lending in Myanmar particularly challenging. This difficulty is further compounded when one considers the “poor accounting and disclosure structures” that, in general, characterize financial reporting.

Even though the amount of financing that MFIs and input suppliers provide to the agricultural sector is likely far more than what is officially reported, the total amount of financing provided to farmers, other primary producers, as well as agribusinesses, is likely much less than what is needed—especially, if capital investment requirements are considered.

Formal credit to farmers is largely provided from three sources: the Myanmar Agriculture Development Bank (MADB), financial cooperatives, and the growing number of MFIs that finance smallholders. So that the MADB can serve as many of the country’s farmers as possible, it limits its financing to farmers with 10 acres or less, and its loans to a maximum of Myanmar kyat (MMK) 150,000 per acre (approx.

---

10 This was a general finding of the World Bank’s Agricultural Finance Support Facility – AgriFin (https://www.agrifinfacility.org/about-agrifin), a program for which the authors of this brief acted as consultants.
11 According to the Financial Regulatory Department (FRD), total lending by all MFIs at the end of December 2016 was US$334 million (data provided directly to the MBI consultants from the FRD).
13 Although no solid data are available, with regard to agricultural lending, through extrapolation, it appears that the cooperative sector is larger than the microfinance subsector. Compared with MFIs’ total lending of US$334 million, credit cooperatives are currently “retailing” US$350 million of a “wholesale” loan from China’s Ex-Im Bank, of which more than 90% of the lending is going to agriculture. This China Ex-Im Bank money is in addition to what the cooperatives are already lending from their own resources.

Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar
US$110)—financing that covers only a fraction of farmers’ production costs. In addition, the MADB focuses almost exclusively on rice production, with the apparent aim of assuring the country’s food security.

In contrast, commercial banks provide virtually no direct financing to farmers. However, this lack of financing from commercial banks is not due to lack of resources. As figures for 2014–2015 show, the loan-to-deposit ratio in the banking sector was roughly 55%, which indicates that the country’s banks have significant liquid assets available to finance the huge untapped market for agricultural lending.

Overly strict regulation and tight supervision have been significant factors that discourage banks from even the most basic working capital lending to primary agricultural producers and agribusinesses. Underlying much of the reluctance to lend is lack of understanding of agricultural sector credit risks, as well as the absence of effective loan generation and monitoring systems in rural areas. Also in short supply is the core skill of designing loan products, other than overdrafts or mortgage loans. However, due to the limited prospects for profitable lending, commercial bankers hesitate to invest in developing the core competencies needed for successful agricultural lending. Among regulations imposed by CBM, the 13% per annum (p.a.) cap on lending rates, and high capital charges for opening branches in rural areas, put pressure on banks’ financial margins. In addition, Myanmar lacks the supporting institutions and agencies that facilitate agricultural finance, including market price reporting services, professional warehouse managers, and crop insurance providers. As a result, Myanmar’s commercial banks opt—for “easier” revenue-making opportunities in other sectors, and particularly in urban areas where most banks have their branches.

Due to the significant growth potential of Myanmar’s agricultural sector, the government’s economic policy states “farmers will have more access to credit.” The MADB’s highly restrictive loan policies, the focus of cooperatives and MFIs only on the needs of smallholder farmers, along with commercial banks’ reluctance to finance the sector, all combine to limit financial outreach to the agricultural sector. In order for the sector to access the capital it requires, and which policymakers want agriculture to receive, the country’s commercial banks need to become more actively involved in financing the sector. For this to be accomplished, however, serious regulatory reforms need to be implemented.

**Regulatory Environment – Myth vs. Reality**

It is often said in Myanmar that overly strict regulations discourage even the most basic lending of working capital to primary agricultural producers and agribusinesses. In meetings with regulators in the supervisory division of the CBM, and with the International Monetary Fund (IMF) advisor to CBM, the authors were told that what banks can do legally is often at odds with commercial banks’ standard

15 An exception is the hire-purchase lending program which finances farm machinery. It must be pointed out, however, that in many cases losses are 100% guaranteed by an international development agency.
17 Aye Thidar Kyaw and Hammond. 2016. “Government reveals 12-point economic policy”.
18 An important option for commercial banks to expand agricultural lending would be by partnering with the MFIs that are already lending in rural areas, and are better prepared to provide finance and financial services to smallholders, but need additional resources.
operating procedures. Also, certain myths have persisted through constant repetition in conversations among bankers and in reporting on the banking sector by interested observers.

What is the source of these apparent contradictions or oft-repeated myths, and why are they so widespread? The contradictions, myths, and confusion are likely the result of the different financial systems operating in Myanmar (banks, cooperatives, and MFIs)—each of which is governed by a different set of laws and regulations. With regard to banks, there are two parallel systems—the government-owned development banks and the commercial banks,19 and this increases confusion about what is, and what is not, permitted with respect to financing the agricultural sector. Many bankers appear to believe that the MADB’s standard operating procedures reflect actual banking regulations. The authors believe this misconception is widely held because the MADB is the source for most of the formal lending to agricultural producers. As a result, many bankers just assume, inaccurately, that MADB operating procedures are regulations that apply to all banks.20

Land as collateral vs. unsecured lending: The authors both read in reports on Myanmar’s financial sector, and were told in interviews, that banking regulations prohibit unsecured lending, and that only property can be used as collateral for a loan. However, in meetings with regulators in the CBM’s supervisory division, and with their IMF advisor, the authors were told that commercial banks were not required to take property as collateral for loans. In addition, interviewees said that commercial banks are not prohibited from making unsecured loans.

Thus, the authors can only conclude that the widely held belief that banks can only take land as collateral is a myth. A contributing factor to this myth appears to be that the MADB “takes” a farmer’s “Form 7” land use certificate as security for a MADB loan.21 In most rural areas, land officially belongs to the state, and individuals only have land use rights, which are usually granted to them through the provision of a Form 7 land use certificate.22 This document can be bought, sold, and used as collateral for a loan. Banks interviewed by the authors are also taking the Form 7 when they engage in rural lending. The active real estate market in Myanmar, especially in urban areas where land titles are readily available, means that a land title is a highly prized asset that can be monetized more easily than most other assets. Banks and regulators both prefer the taking of property as collateral, and banks also seem to be comfortable in assessing property values.

In interviews for this study, a number of bankers reported that when they engaged in unsecured lending, they were severely criticized by CBM regulators who “suggested” that they reconsider their unsecured lending practices. However, while this criticism and advice from financial regulators appears to be well intentioned, it creates uncertainty that deters commercial lenders from pursuing innovative approaches to lending. This confusion also shows that regulators mistakenly believe that if banks take

---

19 If cooperatives and MFIs are considered, then there are three parallel banking systems. Foreign banks are licensed to operate as well in Myanmar, but only within the confines of their rather limited legal “silo”. Thus, effectively, there are four different “banking systems”.

20 It should be noted that originally the CBM was not responsible for the MADB, which was established under its own law. In 2016, the Ministry of Planning and Finance’s Financial Regulatory Department (FRD) was given responsibility for overseeing the MADB, which now also falls under the CBM’s supervision. However, the nature and extent of the FRD’s oversight has yet to be fully defined.

21 It is not clear if, in all cases, the MADB holds the actual land use certificate or only takes a photocopy of it.

22 Therefore, technically, rural land is not used as collateral, but rather the certificate conferring land-use rights which are used as collateral.
property as collateral, they will necessarily reduce their lending risks, and also reduce the likelihood of loan defaults.\textsuperscript{23} It is widely recognized though, that while collateral may not change the probability of a default, presumably it does change the extent of the loss at default, and/or shorten the period of recovery from a loss. This notion, however, only reinforces FIs’ reluctance to lend on an unsecured basis.

**Loan size:** In this study, a few banks reported that they believed they were limited in how much they could lend to farmers (a maximum MMK 1,500,000 – approx. US$1,095). While this limit was imposed by the MADB for its loans, this limit does not apply to commercial banks. The only legal limit on lending applies to individual clients or a group of related clients. This cannot exceed the limit set by CBM regulations, which presently is 20% of a bank’s core capital.\textsuperscript{24}

In the case of MFIs, their maximum loan size restriction (MMK 5 million – approx. US$3,650) means that they are unable to provide value chain financing; their maximum loan size limit restricts them to lending only to smallholder and very small agribusinesses. MFIs cannot provide the larger-scale finance that crop dealers, crop aggregators, and processors require.

**Interest rates:** Bank regulations do, in fact, set a ceiling on loan interest rates. Presently the ceiling for commercial banks is set by the CBM at 13% per annum (p.a.). MFIs, in contrast, can lend at up to 30% p.a., while cooperatives have no interest rate ceiling. The Financial Regulatory Department (FRD) of the Ministry of Planning and Finance, the nonbank regulator that supervises MFIs, is responsible for setting their interest rate ceiling. Interestingly, this 30% p.a. ceiling is at the very low end of the monthly interest rate that informal lenders are reported to charge (2–3% per month).

In addition to the loan rate ceiling, commercial banks also face a deposit rate floor of 8%, though in many cases, current accounts pay no interest. Few commercial banks offer savings/deposit products for more than the 8% floor. Likewise, when commercial banks charge fees, they must be in line with the 13% ceiling—that is that, according to the CBM, the combination of fees and interest rate charges cannot surpass the 13% ceiling. This implies that banks must operate within a spread of not much more than 500 basis points.\textsuperscript{25} In addition to operating within a limited spread, banks also incur high operating costs, and especially high labor costs. This is due to the country’s heavy reliance on cash for all transactions, rather than on other forms of payment such as credit cards, checks, and electronic payment forms.\textsuperscript{26} As such, banks’ thin margins likely create pressure on profits,\textsuperscript{27} a situation that helps explain why banks are reluctant to finance a sector such as agriculture, about which they have limited

---

\textsuperscript{23} Worldwide, a significant amount of finance sector research has examined the relationship between collateral, loan defaults, and loan losses. This research (which this study was not intended to review exhaustively) provides no strong empirical support for the assertion that in comparison to uncollateralized loans, loans that are secured with collateral are less likely to default, or ultimately to result in losses. Furthermore, there appears to be no statistical evidence to support the commonly held notion in Myanmar, and in many other countries, that loans secured by real property are “less risky” for banks than loans that are secured with other forms of collateral.

\textsuperscript{24} Financial Institutions Law, Section 59 (a). These are standard limits to avoid portfolio “concentration risk”.

\textsuperscript{25} The authors were told that, in practice, banks’ average cost for domestically sourced funds is below the 8% figure and, for some banks, running as low as 3%.

\textsuperscript{26} The authors have repeatedly observed that across the branches of Myanmar’s commercial banks, significant numbers of staff are employed as bank tellers, largely engaged in the physical handling of cash.

\textsuperscript{27} It should be noted that commercial banks face both high reserve requirements, and strict limits on loans as a percentage of deposits (LDR), which means that the “credit spread” of 500 basis points is hard to achieve, in practice. Presently, it is impossible to know for certain about banks’ costs and margins since the CBM does not share this information publicly—not even in aggregate form.

*Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar*
knowledge, and which they perceive to be of high risk. This reluctance seems even more logical if the higher costs of loan delivery, supervision, and collection in distant rural areas are taken into account. The CBM-imposed interest rate regime reinforces banks’ preference for making larger loans to urban clients that are close at hand, easier to serve, and can offer the preferred collateral of a land title.

**Pricing risk:** Commercial banks argue, with justification, that the loan rate ceiling does not allow them to effectively price risk. While this is true, it also assumes that banks have the capacity and systems in place to evaluate and price risk accurately. CBM supervisors consider the banks deficient in this area, and the authors agree. Commercial banks are only now beginning to develop in-house capacity for risk analysis and pricing. Several banks have hired foreign risk management experts to assist in developing more modern risk management approaches. On the other hand, one might question whether the CBM itself has the skill to properly evaluate the risk management capacity of Myanmar’s commercial banks.

Unfortunately, effective risk management is only as good as the information available for analysis. In Myanmar, the lack of reliable risk management information systems such as a credit bureau\(^28\) or price reporting mechanisms, among others, mean that banks have to invest themselves to create their own systems for gathering market and borrower-related data. The authors consider that in the short run, most banks will continue to manage risk primarily through conservative lending practices, and continue the ingrained practice of requiring high levels of collateral coverage.

The key point for any commercial bank wanting to serve the agricultural sector is that in order to understand sectoral risks, the bank must make a significant investment to develop staff with the capacity to evaluate agricultural sector risk. This cannot be a “one-off” investment; if a bank is committed to agriculture, it must maintain an ongoing focus on skills and systems development. Such an approach, however, may not be a sensible investment for all banks. In fact, only a few banks will likely want to develop large agricultural lending operations—namely those banks that already have an extensive rural footprint, large agro-processing customers, or a strong interest and the courage to move into a new and potentially lucrative sector.

**Loan tenor:** Presently, the maximum loan tenor (the length of time before a loan is due) has rarely exceeded 1 year, which appears to be another common commercial banking practice that is not mandated by law or regulation. In fact, the authors were told that banks are legally allowed to roll over their loans for up to 3 years.\(^29\) However, the short tenor, and borrowers’ uncertainty about whether their loan will be rolled over at the end of 12 months, makes borrowing for capital investment a difficult proposition. This approach is an obstacle to the proper structuring of loans, with medium- to long-term loans improperly structured as short-term working capital financing. This practice also creates difficulties for the staff responsible for loan and portfolio supervision, as they are managing loans for investment as if they were loans for working capital. Clients are at a disadvantage, too, in terms of their accounting and cash management requirements. In recognition of this problem, Myanmar’s new FIL passed in early 2016, identifies two bank categories: “commercial banks” and “development banks.” A significant

\(^{28}\) Without a credit bureau, it is particularly difficult to determine the creditworthiness of new borrowers, and therefore to price risk.

\(^{29}\) It appears, as well, that tenor limits are responding to the matching of deposit maturities to loan periods. Currently in Myanmar, a bank’s maximum term for a fixed deposit is usually 1 year. As a result, banks also prefer to limit the loan tenor to 1 year. In a large, modern banking sector, this approach of matching asset and liability maturities is normally replaced by a focus on “core deposits”, which in well-run financial institutions are a long-term, stable source of funding. It appears that the CBM is also enforcing a strict matching of loan assets to deposit liabilities, which would be unduly restrictive.

*Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar*
difference between the two is that development banks are allowed to make long-term loans. CBM supervisors told the authors that under the FIL, all banks are required to re-apply for their licenses, at which time they can choose to be either a commercial or a development bank. It is the authors’ understanding that banks have gone through this process, with most opting for a development-banking license.

**Box 2 – The Role of MFIs**

With regard to Myanmar’s microfinance sector, it is important to understand how the current financial regulations impact the capacity of MFIs to serve the agricultural sector, and how this differs from commercial banks. It is also important to examine how MFIs might work in a complementary way with banks to serve both farmers and agribusinesses. MFIs, as mentioned previously in this report, already play an important role in providing credit to the agricultural sector, and particularly to smallholders. Perhaps many of Myanmar’s MFIs are making an unusual number of agricultural production loans to farmers and other kinds of “primary producers”, i.e., people engaged in raising livestock. As with almost everything related to Myanmar’s economy, there is little reliable data with which to make definitive judgments; the authors believe, however, that the microfinance sector in Myanmar is more focused on the needs of the agricultural sector than is the case with microfinance in other countries in the region, where MFI lending is almost entirely in urban areas.

MFI involvement in agricultural lending, particularly on the production side, is generally considered to benefit the country. However, MFIs are restricted by FRD regulations to a maximum loan size of MMK 5 million (approximately US$3,650). While discussions are underway to raise this limit, even at the present level of MMK 5 million, the ceiling may be enough to finance the purchase of inputs for most crops on a small farm, or to purchase enough feed for a small number of livestock, particularly poultry. While, it appears that many of Myanmar’s MFIs provide agricultural finance, no data are available that would enable more detailed analysis. Because MFIs are allowed to charge up to 30% p.a. on their loans, it does appear that MFIs can make a profit from lending to smallholders and other rural dwellers. Commercial banks, on the other hand, facing an interest rate ceiling of 13% p.a., would find it difficult to avoid losing money if they served smallholders borrowing in small amounts.

One of the key challenges facing MFIs is having enough funds to meet loan demand. Recently, the FRD authorized four of the largest MFIs to expand their deposit-taking activities. However, most MFIs have relied on their equity or grants (i.e., from donors) to finance their loan portfolios, which is inefficient, both financially and operationally. This is because MFIs, like banks, need to leverage their capital with borrowed funds, and such sources of funding have been severely lacking. This is partly due to FRD regulations that until 2016, limited MFIs’ ability to borrow. Now that the FRD has removed many of these restrictions, MFIs should be able to add leverage through borrowing from banks. Commercial banks, according to the authors’ analysis, have significant excess liquidity, so should be interested in lending to well-managed commercial MFIs, many of which provide credit to farmers. The obstacles to banks funding MFIs include banks’ traditional reliance on property as collateral (which MFIs cannot provide, though they could offer their loan portfolios as security), banks’ lack of familiarity with the microfinance sector, and banks’ lack of capacity to analyze the various risks in running an MFI.
Conclusions and Recommendations: Aligning Financial Regulation with the Need for Financial Inclusion

Myanmar requires a financial system built to facilitate the financing of agriculture, and to serve the needs of a large, dispersed rural population. Bank regulations and misunderstandings about them have discouraged commercial banks from lending to the agricultural sector. Too much attention has been paid to the drafting of rules and regulations such as those that require banks to follow CBM-mandated loan policy to supply credit to the agriculture sector. Too much effort has gone into drawing distinctions between the different types of financial providers—commercial banks vs. MFIs vs. cooperatives—which among other effects, creates barriers to competition between different kinds of financial providers, competition that would benefit consumers.

For policy makers and regulators, the challenge is stepping back and taking a more holistic approach that considers the needs of the agriculture sector, and of rural dwellers, more generally. They need to recognize that properly designed and implemented regulations not only protect and guide a financial system, but also promote and facilitate growth, inclusion of poorer and rural people, and long-term sustainability of the financial system.

The recommendations below are provided to help bring current and future regulations more into line with the government’s policy objective of expanding access to finance for Myanmar’s smallholders, agribusinesses, and rural dwellers.

Capacity Building is Imperative

Regulators’ skill sets: Awareness raising as well as formal training programs for regulators and supervisory staff are essential for creating a strong and progressive regulatory environment for the financial sector, and these programs will be required on an ongoing basis. It is also important to consider ways to develop and deliver similar programs to the senior policymakers that exercise oversight over financial regulators.

Sector-specific understanding and skill sets are especially important with regard to agriculture. In this sector, risk management is inherently different from other sectors as it concerns biological processes that are often subject to climatic variation. In many cases, crops and livestock require a number of years before revenues and profits are realized. As such, the regulatory environment must facilitate—not hinder—the development of financial products and risk management tools that respond to the unique requirements of agriculture.

Risk management: In the case of risk management, banks will likely develop the capacity to price risk appropriately before financial regulators are able to analyze and evaluate the risk management capacity of banks. That is simply the reality of the financial world. As a solution, the authors suggest that the CBM and FRD consider engaging risk management experts who have experience in other developing countries assessing the capacity of commercial banks to manage risk, and who possess clear understanding of agricultural-related risks and risk mitigation. These advisors could be former regulators or supervisors from developing countries. Development partners could facilitate such engagement by providing technical assistance funding for this purpose.

Research and policy-making: The CBM needs to develop the capacity to produce analytical papers that serve as the basis for policy development, as well as for staff education. Initially, the authors
recommend that research focus on analyzing the impact of interest rate restrictions on agricultural credit flows. In fact, in the area of agricultural and rural finance, there are many worthy topics for further research and analysis.

**Regulatory and Supervisory Evolution**

**Collateral:** Bank supervisors appear to have been strongly “suggesting” that commercial banks only take property as collateral for loans, even though banking regulations do not require this. Unsecured lending is a high-risk proposition, and especially so when there is no reliable means of checking the credit history of new borrowers. Nevertheless, the decision to make unsecured loans to certain clients should be left to an FI’s management, based on the FI’s appetite for risk and its ability to price risk appropriately. Additionally, there should be no limit on what collateral is acceptable, as this restricts the ability of FIs to expand outreach, and so achieve the government’s objective of greater financial inclusion.

While greater flexibility related to collateral is sorely needed, it should also be recognized that bank regulators have the responsibility to ensure the continuity of, and public trust in, the financial system. One option that could allow both flexibility and security would be incorporating trade-off mechanisms. For example, reserve requirements applied to a bank could be adjusted, based on the percentage of unsecured loans in the bank’s portfolio, and/or by the type of collateral that the bank has taken for these loans. This would result in additional reporting requirements, and thus increase costs for an FI. However, the potential returns should more than outweigh any increase in costs. Of course, eventual full adoption of Basel III requirements means that the CBM must ultimately move toward more rigorous, risk-weighted capital adequacy requirements. This will likely necessitate additional training of supervisors so that they can systematize reporting requirements more efficiently, and also supervise compliance.

**Interest rates:** It is generally accepted that interest rate ceilings do not significantly contribute to expanding financial access. On the contrary, interest rate controls may actually limit commercial banks’ lending to certain segments and/or markets, which they view as lower risk and/or higher return—i.e., urban markets, and people and businesses with real property. This works against those who are supposed to be helped by the capped rates—for example, smaller, growing businesses that need working capital. Interest rate caps on bank lending, though designed to make borrowing more affordable, have, ironically, resulted in only the wealthy and propertied classes having access to affordable bank loans.

In Myanmar, the low loan interest rate ceiling strongly discourages banks that might otherwise provide loans to smallholders and the owners of medium-sized farms. Thus, banks do not provide the supply chain financing that would link larger processors or aggregators with farmers who need to borrow for the short term to buy inputs, or borrow for the longer term, to improve their farms.

The interest rate ceiling is considered a significant factor—though not the only one—that discourages commercial banks from financing agriculture. The minimum rate on deposits, and the maximum rate on loans mean that banks have to carefully manage their costs, including taking into account potential losses as a result of the 500 basis point spread. As indicated above, it costs more for banks to serve farmers and other rural customers who are spread out over a wide geographic area, often with poor transportation infrastructure. Commercial banks naturally look for lower cost—and lower risk—clients, as well as markets that match the “footprint” of their urban network of branches. Paradoxically, the
financial regulations covering MFIs that allow them to price loans as high as 30% p.a. recognize the inherently higher costs of providing financial services to the smallest borrowers.

Based on their international experience in developing rural financial markets, the authors strongly support the removal of interest rate floors and ceilings. In Myanmar’s current context, it is more practical to introduce this reform over a period of time—for example, over 3 to 5 years. During this time of transition, banks would be required to develop internal procedures for managing and pricing risk. For their part, regulators would have to develop the skills to assess banks’ risk management systems and risk pricing procedures. In parallel with, or in advance of this reform, deposit interest rate floors should be relaxed, and banks urged to develop and promote long-term deposit products. During the transition, banks would be allowed to adjust interest rates within a certain range, depending on the type of client served. As already indicated, the transition period must be relatively short, with beginning and end dates clearly identified. Regulators should also consider imposing penalties if FIs do not develop risk management and risk pricing procedures by a certain date.

Loan tenor: Under the FIL, banks that have opted for development bank status are free to set the loan tenor (loan maturity period) for their credit products. It is not clear, however, whether regulatory supervisors will continue to “suggest” that banks limit loan tenor, and/or instead require a strict matching of bank assets and liability maturities. Unfortunately, both would continue to discourage longer-term lending.

One essential issue in agricultural finance is the ability to match loan tenor to the production cycle. As mentioned above, lending in the agricultural sector requires bankers to have specialized knowledge of the sector. Regulators also require new skill sets to help them understand whether or not banks are properly underwriting agricultural credit—e.g., setting loan tenors to coincide with crop cycles. Given the need for bankers and regulators to develop new skill sets, now is an opportune time to bring both groups together to discuss the proper underwriting—including the structuring—of agricultural loans.

Branch banking: Unfortunately, banks’ ability to extend their branch network to rural areas is hindered by the CBM’s requirement to hold additional capital for each new branch they want to open. This highly conservative regulatory requirement, although intended to assure bank solvency, and, presumably, to protect the financial system from too rapid expansion, discourages banks from greater outreach in rural areas. This is an example of a banking regulation that, in practice, is more a nuisance than a safeguard.

The need to open bank branch offices may become less relevant if, as the authors recommend below, banks are permitted greater flexibility to work through agents and agent networks, and also as financial technology (fintech) grows in importance. Nevertheless, banks should have the authority to decide where to open branch offices, and not incur punitive capital costs in so doing, especially if they are setting up branches in rural areas. Thus, the CBM should remove the obstacles to opening bank branches in Myanmar’s underbanked rural areas.

Banking agents: The use of bank agents represents another opportunity to extend the reach of banks into the nation’s countryside. Here again, a regulatory void exits. The World Bank, in its 2016 study “Enabling the Business of Agriculture,” states, “it is good practice to allow agents to offer a wide variety of financial services.”30 In conducting this study, the authors were told that in order to operate as a

---

formal bank agent, the agent must first incorporate as a finance corporation. The regulations that would allow non-bank financial institutions to serve as bank agents are included in the FIL. As noted above, it is necessary to clearly set out the licensing process that governs these kinds of companies. As mentioned previously, it is worth considering both MFIs and financial cooperatives as potential rural banking agents.

The role of MFIs: At present, perhaps the only viable option for a commercial bank to reach the smallholder-farmer level is by providing financing to the MFIs and cooperatives that serve rural areas. For now, this form of financial support is a useful “work-around” which should be aggressively promoted. Over time, however, this approach would be rendered unnecessary if the CBM and FRD de-compartmentalize the financial sector by applying harmonized regulations to both commercial banks and MFIs. While the regulations appear to intend the separation of banks, MFIs, and cooperatives, the authors recommend that the three be allowed to compete for the same clients where their customer segments overlap.

In addition, MFIs should be allowed the option of operating as the financial agents of banks, and be encouraged to “move upmarket” to serve “emerging” farmers and small agribusinesses. In the latter case, this would require relaxation of the MFI loan size limit.

Value chain financing: Across many agricultural value chains in Myanmar, it appears to be fairly common for traders and suppliers to finance production-related inputs and activities. If commercial banks were to operate at different levels of the value chain, they could rely on existing value chain relationships as a risk management tool (for instance, to overcome information asymmetries). At the same time, the banks could take advantage of product cross-selling opportunities in order to serve a range of clients, e.g., farmers, small agribusinesses, and large agro-processors.

Value chain financing (VCF) can help banks reduce operational and credit risk, while allowing them to finance multiple actors in the value chain. In other countries, banks often lend directly to farmers where an arrangement exits with an agro-processor client who buys the product, be it an agricultural crop or livestock, from these same farmers. This type of arrangement allows the agro-processor to retain part of what s/he would pay to the farmer, and then remit that amount to repay the farmer’s loan. Such arrangements significantly reduce the market-related risk for the bank. In some cases, these “apex” agro-processors provide banks with a guarantee—known typically as a “first loss guarantee”—to repay a percentage of any loan that the bank makes to the processor’s core group of farmers. In this way, VCF supports the efficient financing of agriculture, and also helps banks to better manage risk.

Commercial banks should be encouraged to develop products for, and engage in, value chain financing. Since this represents a departure from traditional lending practices, regulators need to develop an understanding of VCF concepts. It is particularly important that regulators appreciate VCF as a risk reduction strategy, and that VCF techniques are taken into consideration when evaluating a bank’s risk management capacities. MFIs should also be encouraged to engage in VCF arrangements.

---

31 This would solve problems for both commercial banks and MFIs. Banks, for their part, have a problem with too much liquidity, while MFIs have an acute shortage of funds, and cannot meet demand from the many people who want to borrow from them.

Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar
**Legal and Policy Changes and Supporting Institutions**

Financial system de-compartmentalization: As this report has pointed out, having separate categories of financial institutions—banks, MFIs, and cooperatives—each with its own set of regulations, works against achieving financial inclusion. Also, the compartmentalized nature of Myanmar’s financial market makes it difficult to develop financial structures and products for agricultural value chains. This the case because banks cannot easily or profitably serve smallholders and microenterprises, while MFIs cannot lend to anyone but the smallest businesses and small farmers.

Policymakers and regulators should have, as their objective, the development of a system of financial regulation that is harmonized across different types of FIs, including commercial banks, MFIs, and cooperatives. This should also facilitate the participation of other non-bank financial institutions. Essentially, this means leveling—and unifying—the playing field. In practice, differing licensing and capital requirements may continue to some extent, and restrictions may continue on some types of products offered (particularly deposit products). All manner of FIs should be encouraged to compete energetically for agricultural clients, serve rural dwellers with a broad range of products, and earn a fair profit for this.

Special-purpose financial institutions: There is an acute need for specialized financial institutions in a variety of areas. These range from banking agents, to warehouse receipt-financing companies, to simple finance companies that specialize in agricultural credit. Obviously, these specialized FIs must be properly licensed. At present, the process for becoming licensed as a special-purpose financial institution is not well-defined, though theoretically, it is not prevented by law or regulation. However, without a clear policy to promote special-purpose finance companies for agriculture—or, for that matter, for any other sector—regulators appear to be unsure about why they should allow these new market entrants, and how they should be licensed.

The lack of clear policy, regulations, and licensing guidelines in this critical area discourages innovative non-bank financial providers from entering the agricultural lending market. As noted several times above, agricultural lending carries substantial risks and costs. As depositary institutions, banks are required to safeguard the public deposits that form the core of their funding. For this reason, commercial banks may not necessarily be the best-suited form of FI to serve the credit needs of certain segments of the agricultural sector. Finance companies, with specialist skills and expertise may, in fact, be better equipped than banks to manage the risk of lending to the agricultural sector. This is especially true in specialized product areas, e.g., leasing. It should be recognized, however, that the authors are not suggesting that banks should not lend to agriculture; instead, it is clear that a subset of Myanmar’s commercial banks should, and will be able to develop, the specialized skills needed to make money from agricultural banking.

The authors recommend that the Ministry of Planning and Finance and the CBM jointly develop policies and regulations to allow special-purpose financial institutions (SPFIs) that have the capacity to serve the agricultural sector. These SPFIs would, of course, be barred from taking deposits, and could be limited to providing a narrow range of services. Because they would not likely pose a systemic risk to the financial sector, the licensing requirements and supervisory processes should be simple and agile.

Warehouse receipt-based credit: Formal warehouse receipt-based credit products for agricultural commodities are not available in Myanmar. The lack of a warehouse receipts law and the regulatory
provisions for using warehouse receipts as a financial instrument, clearly hinder the development of this kind of inventory-based lending. Companies that are interested in offering warehouse receipt products have indicated that, at present, their only option is to apply for a finance company license. At this time, however, the regulatory authorities are not encouraging this path. Foreign investors with extensive experience in warehouse management already see opportunities in bringing their inventory financing know-how to the local market, but regulators are not encouraging them. Lack of a suitable policy and a vague licensing process should not be allowed to discourage such innovators.

Companies offering warehouse receipt services should be included under the SPFI designation. Among the first requirements for such an SPFI, should be a minimal level of capitalization that would match the size of the business’ financial risk exposure. Over the longer term, the authors also recommend that the warehouse financing function be supported by either a specific law, or specialized regulations that define the system through clear roles and responsibilities. Supporting institutions should also be established, such as an indemnity fund.

**Facilitating institutions:** While the authors recognize that the development and supervision of facilitating agencies and institutions is beyond the responsibility of regulators, they stress that in order to expand access to credit for rural areas and the agricultural sector in Myanmar, strong supporting institutions are needed. Most importantly, Myanmar needs a modern credit bureau as well as a secured transactions framework that supports a national registry for movable collateral. Both of these are as vital for agriculture and agribusinesses, as they are for other sectors and types of businesses.

More specifically for agriculture, reliable and up-to-date market, price, and cost information should be readily available. Unfortunately, it is not. Lack of reliable data on the agricultural sector, particularly mid-to long-term crop and weather data, prevent insurance companies from adequately analyzing and pricing risk. As a result, private crop and livestock insurance is not offered in Myanmar.\(^{32}\) It should be pointed out though that in many countries, agricultural insurance is heavily subsidized in order to make it affordable. In the United States, for example, farmers pay on average only about 38% of the premium costs, with the remaining portion subsidized by the U.S. government.\(^{33}\) Without an effective subsidy program, which will be an expensive, recurring budget item, it is unlikely that crop and livestock insurance will be widely accepted in Myanmar.

---

References


