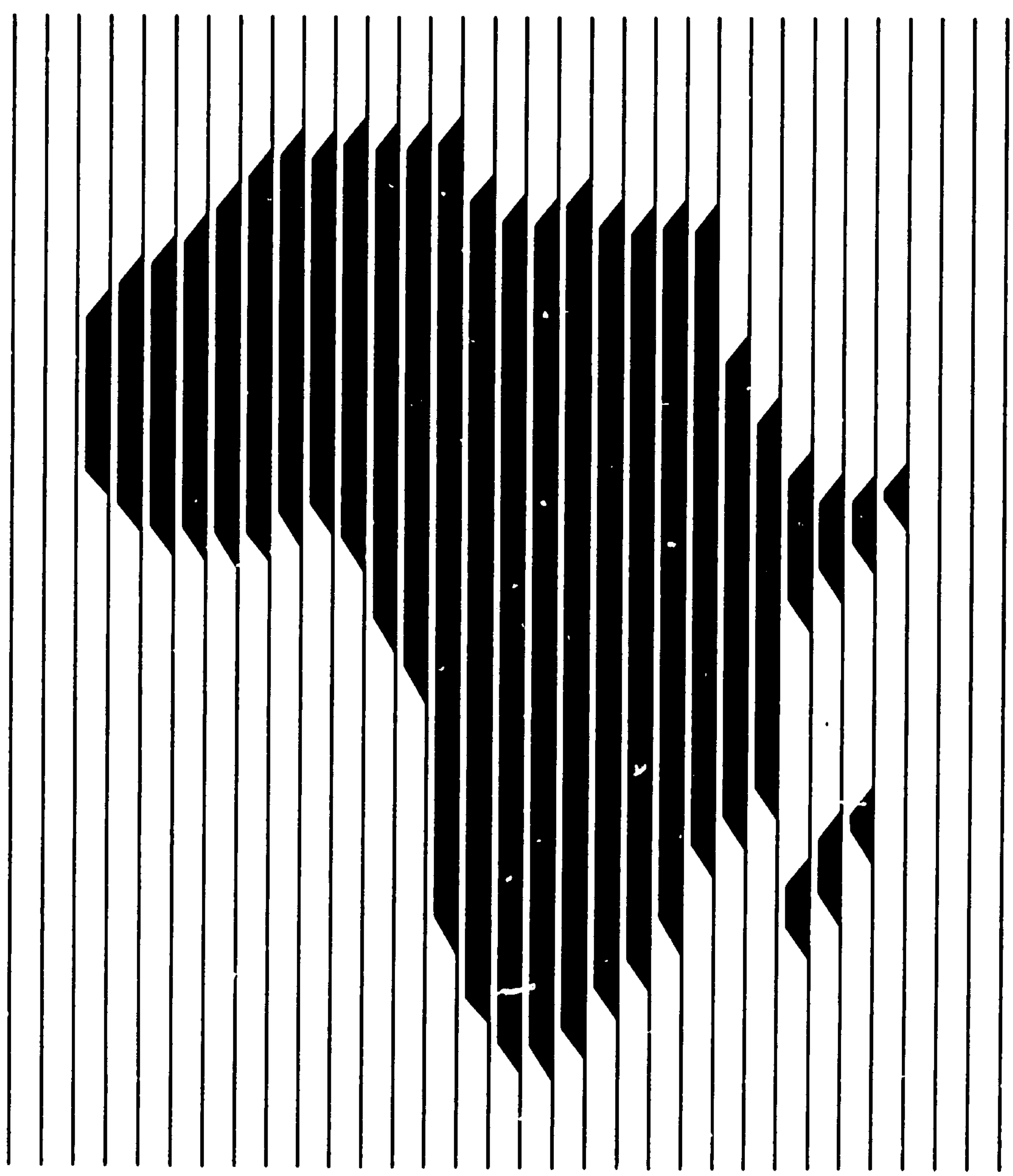
Development Fund for Africa

The Impact of Rural Credit Projects in Africa
A Synthesis Report



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THE IMPACT OF RURAL CREDIT PROJECTS IN AFRICA

A SYNTHESIS REPORT

by

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A SYNTHESIS REPORT

ACRONYMS

AFC	Agricultural Finance Corporation (Kenya)
A.I.D.	U.S. Agency for International Development
ASL	Agricultural Sector Loan I Project (Kenya)
CamCCUL	Cameroon Cooperative Credit Union League
CBK	Commercial Bank of Kenya
CSFC	Cereals and Sugar Finance Corporation (Kenya)
KFA	Kenya Farmers' Association
LCADP	Lofa County Agricultural Development Project (Liberia)
LCCUL	Lesotho Cooperative Credit Union League
MUSCCO	Malawi Union of Savings and Credit Cooperatives
NRDP	National Rural Development Program (Malawi)
SFPC	Small Farmer Production Credit
TCU	Town Cooperative Units (Liberia)

PREFACE

The Development Fund for Africa (DFA) has challenged A.I.D. to take a hard look at the effectiveness and impact of its development assistance to Africa and to make the adjustments needed to improve upon the record of the past.

This series of impact evaluations was undertaken in that spirit. Rural credit was selected both for its historical importance as a component of overall assistance to Africa (rural credit funding accounted for two to eight percent of A.I.D.'s agricultural portfolio over the period 1979 to 1988) and for the lessons which the experience in agricultural lending might provide to guide A.I.D.'s growing involvement in broader financial sector reforms and microenterprise lending.

The five evaluations synthesized here provide a basis for action. The underlying assumptions of our agricultural credit assistance have been re-examined and suggestions for modifications made. The implications for future assistance are clearly drawn. The evaluations encourage us to move in sectoral and institutional directions with regard to sustainable delivery of rural financial services rather than to continue with highly-targeted, supply-oriented approaches.

We trust that these evaluations will prove their worth in coming years.

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FOREWORD

Plumes of smoke drift from clearings in the distant wooded highlands while nearer the tarmac road, small fields lie bare on the slopes and in the valleys. The marshy lowlands are covered in bright green grasses; otherwise the landscape is red, brown and gray. It is October, the end of the dry season in Malawi: time to prepare gardens for the coming rains, to buy fertilizer and hybrid maize seed, to hire extra labor in the fields, perhaps even to buy food if stocks have run low. It is also the start of the school year and school fees are due. In short, it is a time when most Malawians need cash or credit.

About a kilometer from the main highway, the evaluation team arrives at a compound where they are welcomed into a small house where nearly thirty men and women sit. These are the members of the Kechawa Savings and Credit Society. Initially established in 1985 by sixteen members with collective funds of 18,000 kwacha, the Savings and Credit Society has grown to a total of sixty-nine members with almost 50,000 kwacha in funds. The society's good management and success has convinced many otherwise reluctant families to join, despite the collapse of an earlier maize growers' cooperative.

The society is meeting today to prepare its application for a matching loan from the central fund of the Malawi Union of Savings and Credit Cooperatives (MUSCCO). Some members are here to apply for loans for fish trading, burley tobacco and hybrid maize farming, or the purchase of seeds and hoes. Another member plans to buy an ox-cart. About two-thirds of the members are here to get money for school fees; others wish to pay taxes, and some need cash for medical expenses. But the main focus is clearly on agricultural inputs, especially cash to buy fertilizer and to hire labor. By the end of the month, nearly all of the Kechawa Savings and Credit Society funds of 50,000 kwacha will be paid out to members who will use the funds as they choose.

An air of confidence and satisfaction pervades the room. These people know what they want and they are striving to ensure that their funds are well managed and wisely utilized.[1]

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[1]Reeser, R., et. al., *Impact Evaluation of the Malawi Union Savings and Credit Cooperative Organizations Project*. February, 1989.

I. INTRODUCTION

In September, 1988, the Africa Bureau of the U.S. Agency for International Development (A.I.D.) initiated an exercise to assess the impact of its assistance in the area of rural credit. This exercise was carried out in collaboration with Development Alternatives Inc. (DAI) and the Institute for Development Anthropology (IDA) under a contract to provide technical services to A.I.D.

The impact assessments were conducted for three reasons:

* **First**, A.I.D. is responsible for ensuring that its assistance to Africa is as effective as possible. This involves looking not only at the efficiency with which A.I.D. funds are channelled to recipients but also at the impact which these funds have on people's lives over time.

* **Second**, A.I.D. has limited resources with which it can solve problems and it must be constantly searching for the best way to apply those resources. This involves periodic examination of our experience in order to learn ways in which our performance can be improved.

* **Third**, based on our experience in a sectoral activity, such as rural credit, there are lessons to be learned from that experience; theories will be refined or disproved and implementation methods will be tested and modified so as to avoid undesirable effects in the future.

Rural credit activities were chosen as the specific focus of these assessments because there is a generally accepted belief that lack of access to credit is a key constraint to agricultural investment and growth and A.I.D. has completed several projects which have attempted to remove that constraint. Moreover, A.I.D. is continuing to fund activities which involve rural or agricultural credit as well as the development of financial markets.

The methodology selected was that of an impact assessment. Five A.I.D.-funded rural credit projects in Liberia, Cameroon, Kenya, Lesotho and Malawi were examined. Multidisciplinary teams were assembled for each country. After reviewing project documentation, the teams were sent to each country for a three week period during which they had face-to-face discussions with the participants in the credit projects. This enabled the teams to assess what happened during project implementation and what effect each project had on the lives of the people involved.

This report is a synthesis of the five major studies done of the A.I.D. rural credit projects in Liberia, Cameroon, Kenya, Lesotho and Malawi. Two additional studies were also completed by DAI, but these reports were based solely on a review of the existing documentation on two credit projects in Burkina Faso and Kenya. Because these two studies have insufficient information and data to support any conclusive findings, they have not been included in this synthesis report.

The five major credit projects which were the focus of the impact evaluations are described in Section II. The approaches taken by these projects to increase rural people's access to cash or credit are indicated. A synthesis of the major findings of the impact evaluations is presented in Section III. The focus is on what impact these rural credit projects had on production, on the socio-economic welfare of farmers, on the lending institutions involved in the credit projects, and on rural financial market development. The lessons to be learned from these experiences are described in Section IV. These lessons should guide the Africa Bureau as we continue in our efforts to increase agricultural production and marketing and to promote greater economic opportunities for rural people. Clearly then, these lessons will also have implications for the kind of efforts which A.I.D. should be making in African credit markets during the 1990s and beyond. The implications of the lessons learned are summarized in Section V.

II. A SELECTION OF RURAL CREDIT PROJECTS

From among the many rural credit projects which A.I.D. has completed, five major credit projects were chosen for impact evaluation. All five projects assumed that farmers' lack of access to capital was a key constraint to increasing agricultural production. They tried to address this constraint through two different approaches.

* One approach identified specific farmers as the target group and directed production credit towards those farmers through different institutional channels. This was the approach taken by the rural credit projects in Kenya and Liberia.

* Another approach identified credit union systems or institutions as the target group and directed training, technical assistance and limited financial resources towards them in an effort to improve their capacity to serve their members' credit needs. This was the approach taken by the rural credit projects in Cameroon, Lesotho and Malawi.

A. PRODUCTION CREDIT PROJECTS

1. The Kenya Agricultural Sector Loan I Project

In the mid-1970s, the Government of Kenya (GOK) requested A.I.D. assistance in raising agricultural production of wheat, maize and selected cash crops. The GOK sought funds to loan to farmers so that they could purchase the inputs needed to increase production. In 1975 the Kenya Agricultural Sector Loan I (ASL) Project (615-0170) began with a funding level of $13.5 million. The Kenya ASL project attempted to reach more than 30,000 farmers.

There were three components in the Kenya ASL project:

a. $6.7 million was designated for a seasonal (short-term) production credit program for large commercial wheat and maize farmers (an estimated 1,500 farmers, each with holdings of over 20 acres);

b. $3.4 million was designated for a seasonal (short-term) production credit program for small "progressive" farmers, that is, farmers who were familiar with credit programs and who were ready to use new technologies to grow maize, wheat and other cash crops (an estimated 10,000 farmers with an average holding of 6.5 acres); and

c. $3.4 million was designated for production and marketing services for "subsistence" smallholders who had little or no access to such services in the past (an estimated 24,000 farmers).

Production credit was channeled to farmers through several institutions. The A.I.D. loan to the Government of Kenya was on-lent to the Cereals and Sugar Finance Corporation (CSFC), a parastatal arm of the Ministry of Finance. The CSFC then loaned the funds to the Agricultural Finance Corporation (AFC), the Kenya Farmers Association (KFA), and the Cooperative Bank of Kenya (CBK). Both the AFC and the KFA had longstanding agricultural credit programs with farmers. The Cooperative Bank of Kenya extended loans to the cooperative unions which, in turn, made them available to the cooperative societies in the districts in which they served. Farmers who were members of the cooperative societies received the loans. Some of the A.I.D. loan funds were also used to support Ministry of Agriculture, Ministry of Cooperative Development and rural cooperative operations.

All three lending institutions (the AFC, the KFA and the CBK) were to provide some funds for loans to progressive, smallholder farmers, but the CBK was chosen specifically to focus on lending to subsistence smallholder farmers as well. Much of the credit was provided to farmers in-kind (e.g., as fertilizer) rather than as cash.

2. The Liberia Lofa County Agricultural Development Project

The Liberia Lofa County Agricultural Development Project (LCADP) (669-0142) was a multi-donor rural development activity in the poor northwestern region of the country (Lofa County). The project included health and infrastructure components in addition to agricultural support. The World Bank, A.I.D. and the African Development Bank shared the financing of the project which was made as a loan to the Government of Liberia. A.I.D. contributed about $5.0 million of the project's total funding of $18.0 million during Phase I, and was not involved in Phase II. This project began in 1976, completed Phase I in 1981, and was discontinued in 1987 when the World Bank abruptly suspended its funding.

While the LCADP was not primarily a credit project, credit in-kind was an important element in the transfer of the project's four main technological packages to farmers: for improved upland rice cultivation, swamp rice development, coffee planting and cocoa planting. Seasonal production loans were made as well as long-term development loans for tree planting and swamp rice development. Project funds capitalized a revolving credit fund which was administered by the cooperatives. After the project's completion, the cooperatives were expected to take over the supply of all farmer service activities, including credit.

The project organized farmers into Town Cooperative Units (TCUs). These TCUs constituted the bottom tier of the cooperative system and the individual members became the recipients of the project loans. The project brought its loans and technology packages to the TCU farmers through hundreds of agricultural and commercial agents employed as project staff. The TCUs made group site investments in coffee and cocoa tree planting and swamp rice development which typically included building an access road to the group site.

Four agricultural coops were established through project activities in Upper Lofa County, with about 3,700 farmer members. The coops were the sole licensed buying agents of coffee and cocoa for the Liberian Produce Marketing Corporation (LPMC), but they provided few or no extension services or inputs to farmers at the outset of the project. Instead, input marketing and extension services were to be done by the newly created Project Monitoring Unit (PMU) in the Ministry of Agriculture. By the end of the project, service delivery and extension work responsibilities were to be transferred from the PMU to the four regional cooperatives.

B. CREDIT UNION DEVELOPMENT PROJECTS

1. The Cameroon Credit Union Development Project

A.I.D. has focussed its rural credit activities in Cameroon on the development of a strong, rural-based savings and credit cooperative movement. In 1975, A.I.D. funded a technician to assist the Cameroon Cooperative Credit Union League (CamCCUL) and three credit union affiliates to develop and test a pilot small farmer production credit program. Continued support to CamCCUL was provided under Phase I and Phase II of the Credit Union Development Project (631-0044). The project provided technical assistance, commodity support and an operations grant through the World Council of Credit Unions (WOCCU) and the Credit Union National Association (CUNA). Phase I lasted from 1979 through 1985 and was funded by a grant of $1.6 million, while Phase II followed from 1986 through 1989 with funding at $3.2 million.

The principal purpose of Phase I was to strengthen Cameroon's national and regional credit union structures so that they could become financially self-sufficient and technically able to provide essential financial services (savings, credit and related services) required by the increased membership of their affiliated credit unions. The project goal was to increase the net incomes of rural and urban union members, especially poor, lower, and middle incomes families, with secondary impact on those affected by loans through the stimulation of employment generation in agricultural and small business areas. The project established specific targets which would indicate project effectiveness, including increasing the number of affiliated credit unions, the amount of savings, the number of members, the number of loans made, and loan recovery/delinquency rates.

The Cameroon Cooperative Credit Union League (CamCCUL) was the leading implementing agency for the project. The Government of Cameroon did not participate in project implementation.

2. The Lesotho Credit Union League Development Project

The purpose of this project was to expand the availability of cooperative financial services in Lesotho by improving the technical, financial and administrative capabilities of the Lesotho Cooperative Credit Union League (LCCUL) and its member credit unions. The Lesotho Credit Union League Development Project (632-0214) began in 1980 as a three-year, $600,000 A.I.D. activity. The project objectives were that the LCCUL become capable of providing essential services to its member unions, that it become financially self-sufficient, and that it increase membership, savings and productive lending. A.I.D. funds were used to train, hire and otherwise upgrade LCCUL staff. Emphasis was also given to a Small Farmer Production Credit (SFPC) effort and to expanding the credit union league into urban areas.

After a favorable evaluation in 1983, the project was extended for two years with additional funding of about $390,000. The project extension shifted the emphasis of A.I.D. support away from the LCCUL headquarters to the member credit unions. The project extension sought to correct institutional deficiencies at the level of the individual credit unions and to expand their capabilities to mobilize and provide local resources to smallholder farmers for agricultural credit. A.I.D. funds provided a full-time advisor to the LCCUL, training of member credit unions staff, budget support for LCCUL staff and the funding of office expenses.

The LCCUL was both the principal implementing agency and the institutional beneficiary of the project. The project was to relieve chronic fiscal and staffing problems of the LCCUL so that it would have the resources to assist in the promotion of the credit union movement. But during the course of project implementation, the broader goal of improving the LCCUL and member credit union financial services came to be replaced with the more limited goal of improving credit union members' access to production credit. It was believed that improving access to credit would increase investment in improved agricultural practices which would result in increased production and rising farmer incomes.

3. The Malawi Union of Savings and Credit Cooperative Development Project

The goal of this project was to help develop a national cooperative savings and credit union system in Malawi which would provide savings and low-cost credit services to low-income people, especially those in rural areas, so that they could increase production and thereby raise their incomes and standards of living. Through the Malawi Union of Savings and Credit Cooperative Development Project (612-0205), A.I.D. provided about $760,000 in technical, financial and commodity assistance to the Malawi credit union movement. All funding and assistance went to the Malawi Union of Savings and Credit Cooperatives (MUSCCO).

The principal project objective was to develop the institutional capacity of MUSCCO, both in terms of its internal management and its ability to provide essential financial and technical support services to member societies. In addition, the project aimed to develop member societies' operational capabilities, and to increase memberships, total savings and loans. This would ensure that an institutional base was established by which MUSCCO could eventually achieve financial self-sufficiency.

The project began in 1980 and ended in 1985. However, A.I.D. assistance to MUSCCO continued through the Rural Enterprise and Agribusiness Development Institution (READI) project. Between 1986 and 1989, additional A.I.D. funding of about $945,000 was directed towards MUSCCO.

III. FINDINGS OF THE IMPACT EVALUATIONS

The impact evaluations focused on five major themes: the effect of the macroeconomic environment on the projects; and the impact of the projects on production, on the socio-economic welfare of farmers, on the lending institutions, and on rural financial market development.

A. THE MACROECONOMIC ENVIRONMENT AND RURAL CREDIT PROJECTS

The ultimate success of any project, including rural credit projects, is linked inexorably to the national macroeconomic environment and the sectoral conditions prevailing at the time. Factors such as weather, monetary and fiscal policy (especially the exchange rate and interest rates), marketing policies, and commodity prices (both in terms of world market prices and domestic producer prices) had an important effect on the implementation and the results of the projects.

Drought played a significant role in both Kenya and Cameroon. Farmers who had taken loans to finance the adoption of new technologies experienced difficulties when drought reduced yields and constrained their ability to repay their loans. But the effects of the drought varied among farmers. Those farmers who did not rely exclusively on one cash crop or who had non-farm sources of income were less affected by the drought and more able to repay the loans than those farmers who were marginal surplus producers even during the best of times or who were heavily dependent on farming and one cash crop as their sole source of income.

Sharp declines in the world prices for cocoa and coffee dampened the price response of farmers who were encouraged to grow these crops with the new technologies being promoted through the Cameroon and Liberia rural credit projects. In Cameroon, the low fixed producer prices for cocoa and coffee effectively kept returns to agricultural investments below those of other sectors, particularly small and medium-sized enterprises. This made the cost of the credit in-kind disbursed under the rural credit project relatively higher than credit in cash which could be invested as the borrower wished. In Liberia, farmers participating in the LCADP invested in cocoa and coffee trees, but they had difficulty repaying their loans and building upon their initial investment because of the low producer prices offered by the parastatal marketing board and the occasional inability of the board even to pay farmers for crops delivered (due to its liquidity problems).

In Kenya, the macroeconomic and sectoral environments were more favorable. High producer prices for maize and wheat helped to offset increasing fertilizer prices and created a generally favorable investment climate for agriculture. Moreover, adequate marketing arrangements already existed for maize, wheat, and coffee. Similarly, the macroeconomic environment in Malawi was favorable for the rural credit project. Notably, the domestic price regime in Malawi offered incentives to farmers to invest in agriculture and there existed a fairly efficient marketing system. However, the maintenance of negative interest rates continues to jeopardize the financial viability of the institutional credit system created to serve rural clients. Lesotho's economic dependence on the Republic of South Africa and the availability of lower cost agricultural commodities from the Republic has tended to contribute to poor agricultural development.

B. THE IMPACT OF RURAL CREDIT PROJECTS ON AGRICULTURAL PRODUCTION

These projects were based on the belief that lack of credit is the key constraint to increased agricultural production. The projects assumed that: (1) there is a demand for credit among farmers which is not being met; and (2) if the supply of agricultural credit were increased, then farmers would have the means to adopt the technology which would enable them to increase agricultural production. Hence, these projects focussed on increasing the supply of credit to farmers, both in-kind and in cash, through a "directed credit" approach. The production results of this approach were mixed.

In Lesotho and Cameroon, there was a negligible impact on agricultural production, while in Kenya, Malawi and Liberia, short-term increases in production were realized. The impact evaluations found that while directed credit can have a positive impact on production in the short-term, long-term sustainable increases in production may be more difficult to achieve solely through directed credit programs.

There are several reasons for this. First, the directed credit schemes had an adverse effect on the autonomy and viability of the financial entities which are serving farmers (see sections "D" and "E" below). This jeopardized the long-term ability of these entities to meet farmers' needs for financial services which can sustain productive investments. Second, other factors, such as the farmers' own technical skills and knowledge, had a great effect on whether or not directed credit was utilized well. And, finally, sectoral and macroeconomic factors may be more important constraints than credit. For example, as in Kenya, the absence of marketing channels or government trade and pricing policies may ultimately determine the sustainability of production increases.

In Kenya, most of the credit was supplied in-kind in the form of agricultural inputs, which led to higher yields for participating farmers for those years. There was a short-term increase in the production of key commodities. But it was large landowning farmers, who were experienced with the new farming methods and who were known to the major lending institution, who achieved the most sustainable production results. Smallholders, especially those inexperienced with credit, did not receive enough technical assistance and training to adopt the progressive farming methods on a sustainable basis. Moreover, bean and sunflower farmers had problems because the coops were unprepared to market their crops;

this led to spoilage, loss of a major source of income, and a reduced ability to repay the loans.

With land resources stretched to the limit in Malawi, and farm sizes continuing to decrease as the population grows, increases in production can only come from increases in productivity. The MUSCCO project helped farmers improve agricultural productivity by providing them credit in cash with which they purchased fertilizer and hired farm labor. In addition, investments in off-farm activities increased and this improved rural production and incomes. While the impact on a national level is not easily aggregated and may even be insignificant, the increases in food security and income for individual families using loans from the credit unions associated with MUSCCO were assessed to be significant.

> One woman member of a MUSCCO credit society told the evaluation team that she and her husband took out loans of fertilizer through the government-sponsored Farmers Club they had joined. However, at harvest time they took out a cash loan from the local MUSCCO credit society to repay any remaining part of the Farmers Club loan. This enabled the family to store surplus grain at harvest time, when prices are low, and to sell it later in the year, when prices rise.

Attempts to raise production by increasing the supply of credit did not succeed in Lesotho. The impact evaluation found that farming practices in Lesotho are fairly advanced already, with about 60 percent of the farmers using improved seeds, fertilizers and insecticides which they usually buy with cash. Hence, the supply of credit was not the key constraint to improved agricultural production. The most significant constraints to production were macroeconomic: the absence of markets, unsound government pricing policies, superior alternative income-generating activities and the comparative advantage enjoyed by foreign suppliers of agricultural products. Moreover, sectoral problems including population pressure in the lowlands (which has pushed farming into the foothills and compounded an already severe soil erosion problem), the cultivation of steeply graded land, overgrazing and poor range management practices, have had a combined adverse effect on the ability of farmers to increase production.

In Liberia, the project successfully increased the amount of acreage planted with cocoa and coffee and led to the adoption of improved varieties of upland and swamp rice seeds in Lofa County. Providing credit in-kind to farmers tied project-supplied resources closely to the desired production goals but did not relieve all constraints to increased production. While there was a plentiful supply of fertilizer and seedlings on credit, farmers complained about a lack of liquidity needed to hire labor to maintain tree crops and to harvest rice. This points to another finding which emerges from the impact evaluations. Providing credit in-kind limits farmers' abilities to make their own choices about how best to invest their resources.

Indeed, one reason why supplying more credit to farmers in Cameroon did not result in a significant and sustainable increase in agricultural production was that they had better investment opportunities than agriculture available to them. The demand for agricultural production credit was low because there were relatively low returns to agriculture at the time of project implementation. However, the CamCCUL project did avoid the pitfall of targeting credit to explicit economic activities at the expense of other investment opportunities which were being generated by market demand. Because the credit offered was in cash, rather than in-kind, farmers were able to invest it in other productive activities.

C. THE IMPACT OF RURAL CREDIT PROJECTS ON FARMERS' SOCIO-ECONOMIC WELFARE

Those rural credit projects which had the most beneficial impact on the socio-economic welfare of farmers were those that improved farmers' liquidity at key times during the year by making credit available in cash rather than in-kind. Restricting the use of credit to the purchase of specific agricultural inputs limits borrowers' options. Borrowers preferred credit in cash, not credit in-kind; they felt themselves to be perfectly capable of managing their own financial affairs and making sound investment decisions.

The socio-economic impact of the rural credit projects varied among the farmers who were involved in them. One of the objectives of these projects was to increase the socio-economic welfare of the poorest rural households by ensuring access to credit. That is, the projects operated from the assumption that lack of resources was a key constraint for the rural poor, and that providing credit would be the fastest and most effective way to benefit that group. However, this objective often proved to be inconsistent with the need for the lenders to remain financially viable. By making loans to farmers who did not have the productive capacity to generate the surplus needed to repay them, the lending institutions encouraged high loan delinquency rates among poor households. Cutting off these clients' access to future loans was one way to deal with the situation but it did not solve the problem. The extent of the socio-economic benefits realized from these "grants" to the poorer households is not clear from the evaluations. What is evident is that "progressive" farmers proved to be the most likely clients to use directed credit well and to repay the loans made.

This was especially clear in Kenya. The few farmers who repaid their loans were committed to the adoption of improved agricultural practices and they achieved sustainable increases in production and income. The great majority of farmers did not repay their loans and they received what amounted to a cash grant from government. Hence, while improving access to credit helped to improve the socio-economic status of a minority of progressive farmers and smallholders, it was not sufficient to generate the growth in agricultural productivity which the project planners had envisioned. Increasing farmer's access to credit apparently will achieve significant production results only if farmers have the knowledge and ability to apply those funds to the most sound investment opportunity.

The investments made in cocoa and coffee trees in Liberia have created a productive base from which future benefits should accrue to farmers. However, because of severe marketing problems at the coops and the parastatal marketing board, farmers did not receive the full income benefits of the increase in production. In many instances, farmers were paid with warehouse receipts, not cash. This limited their ability to repay their loans and discouraged them from trying to maintain a good credit relationship with the project or the lending institutions. To the extent that farmers could smuggle their crops to Guinea and get paid in cash, they were better off than those receiving warehouse receipts.

Moreover, because it provided credit in-kind and not in cash, the LCADP project was unable to assist rural households to diversify their sources of income-generating activities. Limiting credit to a few major crops meant missing opportunities for directly assisting numerous, small-scale, cash-generating rural enterprises. These include palm kernel and palm oil marketing, and vegetable and peanut production, both of which are women's activities in Liberia, as well as sugar cane production and distilling, which are mens' activities.

> Henry was encountered by the evaluation team as he was riding on his bicycle along the rolling hills of the Kenya countryside. He remembered participating in the rural credit project during 1976, and he described how he received two loans during that year. One part of the loan was made in-kind as seeds (sunflower, beans, cotton and maize) and fertilizer, and the other part was cash for the preparation and weeding of fields. Drought ruined most of what Henry had planted with the first loan, but he managed to qualify for a second loan and by concentrating on cotton he harvested a great deal and repaid the loan even though the market for cotton was down. Henry is no longer producing cotton because of the lack of inputs and high price of fertilizer; instead he has invested his resources in a few dairy cows. Still a member of the local Farmers' Cooperative, Henry is satisfied with the help it provides to him in buying milk cans, in selling his milk and in buying food for his family.

This contrasts sharply with the experience of Cameroon, where credit was available in cash. Indeed, the primary impact which the project had on farmers was to increase the availability of financial services to rural people. The project credit union system has provided a secure, interest-bearing depository which mobilizes savings and finances member's productive activities in rural enterprises. This has helped increase member's access to health and education services, and enabled them to meet their own housing needs and other business and consumer demands.

Similarly, the greatest impact the projects had on the socio-economic welfare of rural people in Lesotho and Malawi was to provide them with savings services through the credit unions. This had a beneficial effect because it enabled rural people to increase their liquidity. With increased liquidity, rural households increased their ability to secure access to health and education services as well as agricultural inputs. In Malawi, MUSCCO extended savings and credit facilities to many farmers who were not being served by the quasi-public Farmers' Clubs. However, the MUSCCO project has not reached all farmers because poverty and low literacy and numeracy skills among many rural people (Malawi has a literacy rate of only 40 percent) prevents them from qualifying for credit. Hence, MUSCCO tends to serve the more progressive farmers who cultivate an average of 2 hectares or more, which constitutes the top 40 percent of Malawi's farming population.

The sign said "Suffer Man's Bar." On its way to meet with the Azire Credit Union staff, the Cameroon evaluation team stopped along the road to Bamenda. The bar owner indicated that his membership in the union enabled him to acquire the bar. Suffer Man joined the Azire Credit Union when he was working as a truck driver. Gradually he built up enough savings and, with a loan from the union to supplement his savings, he bought his own truck. Transporting agricultural produce between Bamenda, Nigeria, and Yaounde, Suffer Man accumulated enough savings to build a large home for his family. He then took another loan and bought three more vehicles which he used to carry passengers and produce to Yaounde. After repaying that loan, he took another loan out and bought a knitting machine for his wife who began making sweaters which were sold in Yaounde. Finally, he bought a small shop to sell drinks and, with the money he saved at the union, he eventually expanded it into a dance hall.

D. THE IMPACT OF RURAL CREDIT PROJECTS ON LENDING INSTITUTIONS

The impact evaluations found that if the projects helped to introduce or reinforce effective, financially sound management at the lending institutions involved in the rural credit projects, there were significant benefits to the institutions. Effective management, especially of the loan portfolio, was found to be critical to maintaining the sustainability of the institution's financial services. In addition, the involvement of the government or donors in directing credit towards target groups was found to have a deleterious impact on the financial viability and independence of credit unions and other financial institutions. Supplementing members' funds to ensure additional directed credit for target groups can apparently overwhelm the absorptive capacity of the credit union or financial institution.

These mixed results were most evident in Kenya. Both the AFC and the CBK made loans to farmers who were enrolled in the credit program because of the project's need to disburse credit, and not on the basis of their credit-worthiness or ability to repay a loan. Consequently, by 1982, the CBK had a project loan delinquency rate of 68 percent while the AFC had a delinquency rate of 73 percent. These delinquencies represented a severe loss of liquidity and resources. The administrative and operating costs of handling the project loan program were also a financial burden on the CBK and the AFC. This contrasts sharply with the impact on the KFA which was careful in selecting credit-worthy clients and disbursed most project funds by making more loans or larger loans to its existing members.

The Lesotho project also had both positive and negative institutional effects. The training and technical assistance which were provided to the LCCUL improved its operating procedures and enabled it to provide better services to members. However, by providing budgetary support for the LCCUL, putting expatriate advisors in place to manage its affairs, and changing the LCCUL's goals to emphasize production credit to farmers, the project completely undermined the LCCUL's independence and self-reliant financial viability. Directing credit to the agricultural sector compromised the ability of the LCCUL to set its own investment priorities in response to market signals and its own member's decisions. The LCCUL ceased being a farmer-responsive, grassroots movement when it began to respond to pressures from the donors and the government.

Positive institutional benefits were achieved in Cameroon because CamCCUL avoided trying to target credit to specific users. The project helped CamCCUL attain financial viability and technical proficiency in the delivery of financial services to its affiliates while increasing the number of affiliates over an expanding geographic region. Standardized accounting, auditing and risk management procedures were developed for CamCCUL, each with a respective operations manual, which improved management capabilities. Technical assistance and training were important in this regard.

In Malawi, the project had a significant beneficial institutional impact. A multi-functional financial institution, MUSCCO, was successfully established and, during project implementation, its capacity and that of its affiliated credit unions to provide services to a wide range of people over a large area was increased. During the project, the number of affiliated societies grew and the amount of savings and loans made to members continued to increase. Yet, MUSCCO has been careful not to expand too fast because it lacks skilled financial managers at the regional level and especially at the village level. Moreover, because of adverse experiences with previous cooperatives, such as the Farmers' Clubs, many rural people are cautious about joining the new credit unions and entrusting their savings with the MUSCCO affiliates.

The institutional impact in Liberia was found to be generally negative. Credit was viewed as a means to disseminate agricultural technology and, as a result, financially sound decisions about lending were not always made. Inadequate management of the credit program led to low loan repayment rates and financial insolvency for the cooperatives. Indeed, the coops themselves were organized as marketing entities and they never fully matured into multi-functional, independent institutions. Moreover, the centralized, hierarchical administrative structure of the coops did not correspond to local patterns of social organization, authority, aspirations or interests. Therefore, farmer interest and participation remained low.

E. THE IMPACT OF RURAL CREDIT PROJECTS ON FINANCIAL MARKET DEVELOPMENT

One of the most important findings of the impact evaluations is that access to credit is not the most critical constraint to productive activity in rural areas among most farming households. The key constraint appears to be a lack of liquidity. This is a subtle but important distinction to make. Farming households earn most of their incomes at harvest time, but they need that income throughout the year, and especially at planting time. Hence, what farming households need the most is not directed credit at planting time, but year-round access to both savings and credit financial services which will enable them to save their cash when they earn it and to spend it as the need or opportunity arises. Entities which offer both savings and credit facilities improve the ability of rural households to manage their resources and their cash flows.

This finding has important implications for the development of rural financial markets. It indicates that there is a demand for financial services which is not being met in rural areas. Hence, credit unions which offer secure deposit (savings) services and which follow sound lending practices were found to be more attractive than purely lending institutions to all clients. By offering both savings and lending services to farmers, these entities contribute to the development of rural financial markets.

Moreover, it was found that viable, well-managed credit unions can play an important role as intermediaries between formal sector financial institutions and markets and the small, rotating rural savings and credit societies found in the informal sector. While the impact of these credit unions on national financial markets may be small, their impact locally can be large and significant.

Only the Cameroon project had a strong, positive impact on rural financial market development. Its success is attributable to the fact that the credit unions affiliated with CamCCUL effectively bridged the gap between rural, informal financial markets and urban, formal sector financial markets. CamCCUL achieved great success precisely because it built upon the indigenous informal savings and credit associations which existed in rural areas. By creating and operating rural savings and credit facilities, CamCCUL met rural savers' demand for safe depositories and borrowers' demands for credit and liquidity. Indeed, one indication of the degree of CamCCUL's success is that it was able to continue to provide financial services at a time when the formal financial market was experiencing a severe liquidity crisis. (Cameroon's financial crisis was brought on by declining export revenues from oil and coffee, decreasing government revenues and deposits, losses on accumulated bad debts at the major financial institutions and declining consumer confidence in the banking system which exacerbated the erosion of the capital base of the formal financial sector institutions.)

> The Mensai Women's Group is the type of informal savings and credit association which has existed in Cameroon since pre-colonial times. This association of twenty women united specifically for the purpose of pooling resources for investment. Using their mutual contributions, they joined the local credit union as a group (most women already were individual members of the credit union). This enabled the Women's Group to have access to a secure deposit facility, it increased their ability to maintain liquidity, and it enabled them to earn dividends on their savings and to borrow funds at a low interest rate. From the credit union, the Women's Group secured a loan to purchase a corn mill which they operated to meet their members' own milling needs and as a profit-making venture (commercial processing of grain for their neighbors).

The Malawi project also had a beneficial impact on rural financial market development by increasing the quantity and the quality of financial services available to rural people. However, the ability of MUSCCO to sustain those services to rural households is in jeopardy because of the macroeconomic policies resulting in negative interest rates on deposits.

Malawi has a network of well-distributed postal savings banks which provide depository facilities, but they do not extend loans. Hence, even though farming households had access to savings facilities, the lack of access to credit services was found to be a constraint on investment and increased productivity. In addition, while the government provides credit to farmers through Farmers' Clubs under a National Rural Development

Program (NRDP), it is only credit in-kind, the Clubs have selective membership criteria, and they use harsh loan recovery methods. In 1986, only 16 percent of the nation's smallholders received credit through the NRDP. Hence, there is an unmet demand for balanced financial services, especially loans, in rural areas.

MUSCCO helped to meet the demand for financial services which many rural households have. Savings activities increased in rural areas as a result of the MUSCCO project, primarily because, in order to qualify for a loan from a MUSCCO affiliated credit union, a client had to have some savings on deposit there. Moreover, membership in a MUSCCO affiliate enables clients to get one cash loan large enough to cover many of their credit needs. Some members even use the loans from MUSCCO to repay their debts with the NRDP Farmers' Clubs.

However, it is not clear whether there has been a net increase in savings in rural areas. Negative interest rates in Malawi are a disincentive for savings and they are contributing to a gradual decapitalization of the MUSCCO financial system. In addition, the persistent poverty of the target group of rural farmers is a constraint to savings mobilization. Many poor Malawians have neither the resources to make productive use of loans nor the ability to repay the loans. As a result, the credit unions cannot generate enough capital through savings mobilization to meet the demand for credit from their clients. This causes them to turn to the MUSCCO central fund for additional financing. MUSCCO, in turn, must borrow in domestic or international markets to secure capital for the central fund. Unless interest rates become positive, this will leave the MUSCCO system in a precarious financial position.

The impact of the other rural credit projects on financial market development was negative. In Lesotho, the project sought to impose a financial service (agricultural production loans) on farmers for which there was no demand, nor did it fit with the LCCUL's business needs. Consequently, this actually undermined the link in financial services between the LCCUL and its clients. Loan delinquency increased at member credit unions because the objective of disbursing funds for specific farming activities overwhelmed the ability of the unions to manage and administer those loans.

In Kenya, the project introduced distortions into financial markets. The project was implemented without attention to mobilization of savings and thus most participants did not increase their access to financial services. Moreover, by supplying significant amounts of funds for target activities, the project actually reduced the incentives for financial institutions to mobilize their own resources. In addition, as the supply of credit far exceeded the demand, it led to political interference in the decision-making process for loans at the AFC and CBK. This further distorted financial market development.

Financial market development in Liberia was not promoted by the LCADP. Cooperative management was weak and their loan monitoring and recovery efforts were poor. Consequently, loan delinquency was high and there were no funds generated to create a revolving fund for future coop lending. More significantly, the LCADP coop system did not build on existing informal rural savings mechanisms or community associations; local leadership was nearly absent from the coop structure and local participation was unenthusiastic. Hence, the demand for financial services did not increase nor did participation in formal financial entities increase.

IV. LESSONS LEARNED FROM THE CREDIT PROJECTS

Three key lessons emerge from the impact evaluations of these rural credit projects:

* **First,** it is critical to the success of any activity that there be local participation and local control in the activity at all levels. The extent of any activity's success will relate directly to how much it builds on local resources and local involvement.

* **Second,** entities which offer both savings and credit services to farmers will be more valuable to them than one-dimensional entities. The more narrow the services, the more limited the beneficial impact such an entity will have on rural development. The broader, and more flexible, are the services offered, the greater the chance the borrowers will make sound investment decisions.

* **Third,** the principles of sound management and financial viability should be followed by agricultural credit institutions or there will not be a sustainable positive effect on rural development.

A. LOCAL PARTICIPATION/LOCAL CONTROL

It is relevant to note that most African societies traditionally have emphasized the importance of savings and the exercise of mutual responsibility among groups of people who pool their savings. Many rural people participate in various kinds of traditional, informal, rotating savings and credit societies. The extent of their ability to draw upon the collective resources of the group is usually directly proportional to their ability to save through regular contributions to the group. In Cameroon these groups are known as *njangi*; in other parts of West Africa (Liberia, The Gambia, Senegal, etc.) they are known as *asusu*, *tontines*, or *banques populaires*. In Lesotho, women belong to mutual funeral societies which serve a similar, albeit limited, function. (It is unclear from the evaluation whether or not Malawi is exceptional in that mutual aid societies do not seem characteristic of their traditional societies.)

The rural credit projects which enjoyed the greatest sustainable success were those that mobilized the project beneficiaries and built upon their traditional practices. That is, the approach tended to be bottom-up rather than top-down. Local people need to be involved at all levels: it should be their resources which are being mobilized through savings; they should be managing the financial entity which is collecting and investing their savings and making loans; and they should be the recipients of the loans. The greater the investment by local people in the project activity, the greater will be their interest in seeing their investment succeed. The most successful rural credit project in this regard was the CamCCUL project.

When the resources come from the local community, decisions on how to use those resources should naturally rest with the local community. Hence, it is critically important that financial entities allow clients to make their own decisions about where to invest the funds which they borrow. Attempting to direct investment into one activity or another will not guarantee the success of that investment. In fact, it may have quite the opposite effect. This tendency to direct funding at target activities can best be avoided by ensuring that there is maximum local participation in managing the financial entity, because local people usually have the best knowledge about where the optimal local investment opportunities are.

B. FINANCIAL SERVICES

A second lesson that emerges from the impact evaluations is that agricultural credit projects have overemphasized one financial service and neglected the other, to the detriment of sustainable agricultural and rural development. Agricultural credit projects, including the five rural credit projects evaluated here, have tended to utilize financial entities to increase the *supply* of credit to farmers in order to help them improve agricultural productivity. This approach has been driven by the assumption that there is an unmet demand for credit in rural areas. However, the lesson that clearly emerges from these studies as well as other research in financial markets, is that the real *demand* among farmers is for increased liquidity. The best method to improve farmers' liquidity is not to offer them more credit, it is to also offer them more savings services and facilities. In financial terms, savings activities provide the funds to sustain lending activities; there must be balance in the financial equation. Overemphasizing either credit services or savings services will create financial imbalances in the rural economy.

Financial entities that offer safe, reliable savings and credit services mobilize the resources of rural households through savings, and help their clients to manage their cash flows and improve their liquidity through loans. Another lesson that emerges from these impact evaluations is that many people save on an irregular basis. There are variations in people's behavior and variations in the risks that they confront. Opportunities for investment, sudden illness, and other demands for cash are triggered at irregular intervals. Improving rural household liquidity, access to cash resources when they are needed, is a critically important way to assist them improve their socio-economic welfare.

Rural credit projects or rural financial entities should avoid targeting rural credit solely to agricultural investment. Recent studies, including these impact evaluations, indicate that most farmers do not earn all of their income from farming, that a significant proportion also comes from off-farm employment. Indeed, some studies argue that the only way to improve incomes for many poor rural households (especially those that usually own less land and have fewer resources to invest in agriculture) is to improve the opportunities for off-farm employment in rural areas. Indeed, these evaluations illustrate that sometimes the best investment opportunities farmers can make are not on the farm but in some off-farm activity, such as a butcher shop, a sewing machine, a local distillation or beer-brewing operation, and the like. It is important to encourage these kinds of investments for two reasons: they diversify the income-generating activities of rural households and they spread their risks out. Moreover, these activities can complement farming activities and accelerate rural economic development.

Rural credit projects and rural financial entities should also avoid involvement in loans that take the form of credit in-kind. Making funds available to farmers as cash allows farmers themselves to make decisions about how best to allocate their resources to achieve increased agricultural productivity. Making loans in-kind constrains a farmer's decision-making ability Also, if the loan is made in-kind (as fertilizer, pesticide, herbicide, farm implements), and then the crop fails because of factors beyond the control of the farmer (drought, pests, flooding, and so forth), the farmer will have more difficulty repaying the loan then if the loan was made in cash and available for other use. Moreover, providing a loan in-kind does not prevent farmers from selling the inputs provided on credit. (Cross-border sales of fertilizer to generate income achieve the same result as a cash loan). There is no guarantee that the credit in-kind will be used as the project designers had intended.

C. INSTITUTIONAL VIABILITY AND SUSTAINABILITY

A final set of lessons learned deals with the institutions themselves. It is clear from nearly all of the evaluations that a significant constraint to the sustainability of financial institutions is the ability of the staff to manage the savings and lending activities. Not only is it important for the central organization (CamCCUL, MUSSCO, etc.) to be staffed with capable financial managers, it is also important that efforts be made to improve the technical and administrative abilities of rural people (even those who are illiterate or under-educated) to evaluate loan applications, keep financial records, and manage and collect on loan portfolios.

Unless the principles of sound financial management are observed by the managers of the financial entity, the organization's viability and sustainability will soon be jeopardized. Sound financial management in this context means that the credit union or other entity must carefully select how it invests the savings of its members and to whom it makes loans. As the evaluations show, this is not easy. The people who are the best risks as borrowers are usually those who have a demonstrated capacity to save. In rural areas, these are usually the "progressive" farmers. With a high level of local involvement in lending decisions, loans can be made on the basis of the known financial viability of the client.

However, one the lessons learned from these rural credit projects is that the small, poor rural households that are often a key target group in agricultural lending projects, are the clients least able to repay the loans extended to them. Hence, forcing credit unions or other financial entities to extend them credit out of proportion to their capacity to save or to generate surplus violates the principles of sound financial management. External pressure on a lending institution to get credit into the hands of target farmers may overwhelm the administrative and technical capacity of the lending institution to evaluate the credit-worthiness of potential borrowers and to manage the loan portfolio. It will impose an administrative and managerial burden that will increase the cost of doing business. Moreover, pressures to get credit in the hands of all the farmers will tend to overwhelm the issue of the credit-worthiness of the borrowers and result in high loan delinquencies that will threaten the long-term financial viability of the lending institution. Once the entity begins to lose its financial viability, it commensurately loses the confidence of its best clients, which will further threaten its existence.

This creates a dilemma for governments and donors that are interested in helping the poorest rural households to improve their socio-economic welfare. There is often an inherent contradiction between the need of a financial entity to make loans only to those clients who are best able to repay and the desire of governments and donors to provide assistance to the poor. Providing an initial capital-infusion to rural households, a one-time only cash grant, may help some households get a "kick-start" in the process of improving their ability to generate surplus on a sustainable basis. But capital alone will not be enough. The poor need to have the resources and skills to apply that capital to increase their income-generating activities and markets in which to sell their products. Without sufficient land, labor, knowledge, skills, or markets, better access to agricultural inputs may not make an appreciable difference in the ability of the poor to increase productivity.

The issue of equity, how to reach the rural households living in a resource-poor environment, has not been resolved. And, essentially, it is related to the issue of risk. Who should bear the burden of the risk of lending to marginally financially viable rural households? These farmers may not be good credit risks because they are not financially viable. They may be landless or they may live in such a marginal area that they truly are "subsistence" farmers who, even at the best of times, are barely able to eke out a living from farming and other activities. If they are involved in a credit scheme and given cash or credit in-kind and then they experience crop failure through bad weather, pests, or other natural causes, they may be unable to pay back their loans. Should governments forgive the loans and then extend subsequent ones? This does not seem to be a financially sound policy because either the government, the donor, or the lending institution itself will have to absorb the loss caused by these loans. In addition, absolving some poor rural households of the responsibility to repay their debts will have a deleterious impact on all rural debtor behavior. Perhaps the best way to reach these poor farmers is through changes in policies that will allow maximum producer prices to be paid to these farmers or through some form of a rural training scheme that helps them to improve their skills.

V. CONCLUSIONS

Even though the projects evaluated here were carried out under widely-differing circumstances and had widely-varying levels of impact, five fairly clear conclusions can be drawn from the findings of their experiences. These conclusions might prove useful to both project designers and managers as they try to support efforts to increase agricultural production and develop rural financial markets in Africa over the coming years.

* Trying to direct credit to certain purposes or to certain users should be avoided. Financial entities must have the flexibility to respond to the changes in the economy and the status of their clients. Rural households also must have the flexibility to move resources between different activities in response to shifts in market signals and investment opportunities.

* Technical skills in financial entities that are trying to serve rural clients need to be solid. These include financial management skills, accounting and book-keeping skills, and knowledge of sound business and lending policies and procedures. Effective management, especially of the loan portfolio, was found to be critical to maintaining the sustainability of the institution's financial services. Hence, perhaps the most significant contributions that aid programs can make to the development of viable and sustainable financial entities in rural areas is to provide both in-country and third-country training in technical, financial, and administrative subjects for the staff of rural financial organizations.

* A lack of technical skills among farmers regarding the use of productivity-enhancing technology affects their capacity to be good borrowers. Those farmers who used agricultural credit the most wisely, especially when it was provided in-kind, were "progressive" farmers, or farmers who had some knowledge about the use of the inputs and the skills to apply them in the appropriate manner. Progressive farmers also were the most financially viable farmers and the most likely to be able to repay their loans. Hence, rural production projects and activities must be able to distinguish between their clients and make allowances for providing the appropriate level of technical assistance and training to those farmers who lack the skills and the knowledge necessary to use new technologies and farming methods wisely. Such complementary activities, especially in

training, will help to ensure the successful adoption and ultimate sustainability of the new farming practices by raising the skill level of poor farmers.

* Trite but true: project designers must be attentive to the local socio-cultural environment in which the project activity will occur. These studies illustrate again that those projects that identify and incorporate local traditional practices or institutions that are similar to the proposed activities, or which can complement project activities, will be the most successful and sustainable interventions. This can best be achieved by involving the local people in project design and mobilizing their own resources in carrying out the activities.

* Finally, the unresolved issue of what is the best way to help poor rural households to improve their socio-economic welfare remains unsolved, but it appears unlikely that suppling credit is a "best way." Poor rural households were the least able to repay the loans extended to them unless they had also accumulated some savings against which their loans were guaranteed or they were also provided appropriate assistance and training in how to apply that credit to productive investments. And, as other empirical studies are showing, resource availability, markets, and the level of technological skills available are also important.

APPENDIX

A COMMENT FROM USAID LESOTHO

ACTION COPY

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INCOMING TELEGRAM

Department of State

ACTION AID-00

ACTION OFFICE AFDP-06
INFO AFSA-03 AFPD-04 AFCO-02 AFTR-05 AAAF-03 AFPE-07 BIFA-01
SAST-01 GC-01 GCAF-02 ES-01 PRE-06 STPO-01 STFA-01
STHR-01 STRD-01 STAG-02 SDB-02 SEOP-01 SERP-01 AMAD-01
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UNCLAS MASERU 01780

AIDAC

FOR AFR/DP EMMY SIMMONS AND AFR/TR/ANR TOM HOBGOOD

E.O. 12356 N/A
SUBJECT: RURAL CREDIT IMPACT EVALUATIONS

REF: SIMMONS/REINTSMA MEMO OF APRIL 19

1. REF MEMO REQUESTED COMMENTS ON THE LESOTHO PORTION OF THE RURAL CREDIT IMPACT EVALUATION. THE REQUEST WAS MAINLY FOR COMMENTS ON THE COUNTRY STUDY BUT ALSO WANTED TO KNOW IF THE SYNTHESIS REFLECTS THE IMPORTANT LESSONS FROM THE STUDY. COMMENTS IN PARA 3 AND 4 BELOW ARE ON BOTH THE STUDY AND THE SYNTHESIS REPORT, AND PARA TWO PROVIDES A BRIEF UPDATE OF DEVELOPMENTS SINCE THE REPORT WAS CARRIED OUT. NO COMMENTS ARE PROVIDED ON THE APPENDICES.

2. UPDATE. THERE HAVE BEEN SIGNIFICANT DEVELOPMENTS SINCE THE COUNTRY STUDY WAS UNDERTAKEN. FOLLOWING THE EXPOSURE OF SERIOUS WEAKNESSES IN THE CREDIT UNION ACTIVITIES, A MAJOR ATTEMPT WAS MADE TO REVISE PAST APPROACHES, AND CONTINUED SUPPORT TO THE LESOTHO COOPERATIVE CREDIT UNION LEAGUE (LCCUL) BY USAID AND CUNA/WOCCU WAS MADE CONDITIONAL UPON A RESTRUCTURING OF THE ORGANIZATION AND ITS APPROACHES. SPECIFIC CONDITIONALITY WAS DESIGNED TO ACCOMPLISH THIS. BY EARLY 1990, IT BECAME APPARENT THAT THE RESTRUCTURING WAS NOT PROCEEDING AS PLANNED. THE FOREMOST PROBLEM APPEARS TO BE A FIRM COMMITMENT TO THE STATUS QUO ON THE PART OF THE MANAGEMENT OF THE MOVEMENT. AS A RESULT, USAID AND CUNA/WOCCU HAVE WITHDRAWN ALL SUPPORT TO LCCUL. WE CONTINUE TO MONITOR CREDIT UNION DEVELOPMENTS, HOWEVER, IN THE HOPE THAT A DEMOCRATIZATION OF THE MOVEMENT WILL EVENTUALLY LEAD TO FUNDAMENTAL CHANGES.
IN THE MEANTIME, USAID HAS CARRIED OUT A COMPREHENSIVE STUDY OF RURAL FINANCIAL MARKETS IN LESOTHO (COPIES ARE BEING POUCHED TO YOU). AS WELL AS PROVIDING AN EXCELLENT ANALYSIS OF THE OVERALL SITUATION, THE STUDY HAS IDENTIFIED SOME POTENTIAL INTERVENTIONS THAT WOULD TAKE ACCOUNT OF PAST LESSONS LEARNED IN LESOTHO AND ELSEWHERE. WE ARE CURRENTLY ENGAGED IN A DIALOGUE WITH THE LESOTHO AGRICULTURAL DEVELOPMENT BANK, WHICH MAY LEAD TO AN ASSISTANCE PACKAGE THROUGH ONE OF OUR FY 92 NEW STARTS IN AGRICULTURE.

3. COUNTRY STUDY: OVERALL COMMENTS. THE FACTS ABOUT THE CREDIT UNION INSTITUTIONAL STRENGTHS AND WEAKNESSES ARE ACCURATE SO FAR AS WE CAN DETERMINE. THE CREDIT UNIONS EXAMINED IN THIS STUDY ARE ALL CONSIDERED TO BE ACTIVE ONES. SINCE MANY REGISTERED CREDIT UNIONS IN LESOTHO ARE NOT ACTIVE, THE SAMPLE MAY, IF ANYTHING, CONTAIN A POSITIVE BIAS TOWARD THE CREDIT UNION MOVEMENT

AS A WHOLE. WHILE THE LANGUAGE IN THE FIRST DRAFT REPORT WAS PROVOCATIVE, EARLIER FEELINGS THAT THE REPORT WAS BIASED AGAINST THE CREDIT UNION MOVEMENT HAVE NOT PROVEN TO BE THE CASE. OVERALL WE BELIEVE THE REPORT TO BE FACTUAL AND THE MAIN CONCLUSIONS ARE SOUND.
SPECIFIC COMMENTS. THE REPORT DOES NOT GIVE A CLEAR PICTURE OF THE SIZE AND STRENGTH OF THE AVERAGE CREDIT UNION. HAD THE FOLLOWING INFORMATION BEEN INCLUDED IT WOULD HAVE STRENGTHENED THE REPORT.

- AVERAGE SAVINGS PER MEMBER - -	M 114
- AVERAGE ORIGINAL LOAN AMOUNT PER BORROWER	M 201
- AVERAGE CURRENT LOAN BALANCE PER BORROWER	M 164
- AVERAGE AGE OF MEMBERS - - -	47
- MALE - - - - -	28 PCT
- FEMALE - - - -	72 PCT
- LOANS TO SAVINGS RATIO - -	87 PCT
- TOTAL DELINQUENT LOANS - -	34 PCT
- DELINQUENT, UNSECURED LOANS -	14 PCT

LOANS IN THE ABOVE EXAMPLE WERE NOT CONSIDERED DELINQUENT UNLESS THERE HAD BEEN NO ACTIVITY ON ANY ACCOUNT OF THE MEMBER FOR OVER ONE YEAR AND NO LOAN ACTIVITY FOR OVER TWO YEARS. THIS IS OBVIOUSLY A LOOSE DEFINITION OF DELINQUENCY, AND DEMONSTRATES THAT CREDIT UNIONS FACE SUBSTANTIAL EXPOSURE TO LOAN LOSSES. SINCE THERE ARE NO RESERVES TO DRAW UPON, RURAL MEMBERS' SAVINGS ARE DANGEROUSLY EXPOSED.

ESTIMATES IN THE REPORTS ARE THAT THERE WERE 36 ACTIVE CREDIT UNIONS AT THE END OF THE LCCUL PROJECT AGAINST A TARGET OF 90. IN FACT, THE FIGURE IS PROBABLY CLOSER TO

25 ACTIVE CREDIT UNIONS. AND EVEN THESE MAY TURN OUT TO BE VIABLE ONLY IF LOCAL MANAGEMENT CAN BE IMPROVED.

THE REPORT CITES THE MISGUIDED DEVELOPMENT EFFORTS OF VARIOUS PROJECTS, ESPECIALLY PRODUCTIVE CREDIT PROJECTS, IN UNDERMINING THE DEVELOPMENT OF THE CREDIT UNION SYSTEM. WHILE THIS HAS BEEN A MAJOR DISTORTION IN THE DEVELOPMENT OF THE CREDIT UNION SYSTEM, IT IS NOT THE WHOLE PROBLEM. THE HISTORY OF THE DEVELOPMENT OF THE CREDIT UNION SYSTEM IN LESOTHO HAS BEEN TOP-DOWN AND THE DEMOCRATIC PROCESS HAS NOT BEEN EFFECTIVE. MANY MEMBERS HAVE NOT FELT OWNERSHIP OF THEIR ORGANIZATIONS AND AS A RESULT, IN MANY CASES, A SMALL LOCAL ELITE HAVE MANAGED TO SECURE CONTROL OVER THE LOCAL ORGANIZATIONS. IN SOME CASES, THESE SAME INDIVIDUALS HAVE TAKEN OUT LOANS AND NOT REPAID THEM, MAKING IT DIFFICULT FOR CREDIT UNIONS TO COLLECT LOANS FROM ORDINARY MEMBERS. THIS PROBLEM EXISTS AT ALL LEVELS OF THE CREDIT UNION SYSTEM. THE PROBLEM IS FURTHER EXACERBATED BY DIFFICULTIES IN ENFORCING LEGISLATION INTENDED TO PROTECT MEMBERS FROM SUCH ABUSES.

ANOTHER MAJOR FACTOR IN THE MALDEVELOPMENT OF THE CREDIT UNION SYSTEM HAS TO DO WITH INTEREST RATES. THIS IS NOT ADEQUATELY TREATED IN THE REPORT. THE LCCUL PAYS CREDIT UNIONS NEGATIVE REAL RATES OF ABOUT 6 PCT ON THEIR DEPOSITS AND CREDIT UNIONS IN TURN PAY ONLY A TOKEN 1 PCT OR 2 PCT DIVIDEND (INTEREST) ON THEIR MEMBER SAVINGS. THE MARGIN BETWEEN THE AMOUNT PAID TO CREDIT UNIONS BY THE LCCUL AND THE AMOUNT RECEIVED FROM INVESTMENT IN BANKS IS ABOUT 10 PCT. LOANS TO CREDIT UNIONS ARE MADE AT 15 PCT. ANNUAL INFLATION AVERAGES 15.5 PCT. RECENT EFFORTS TO MOVE TOWARD MARKET BASED RATES HAVE BEEN OPPOSED BY MANAGEMENT. THIS RATE POLICY HAS CAUSED A STAGNATION OF SAVINGS AND HAS UNDERMINED THE VIABILITY OF

INCOMING TELEGRAM

Department of State

THE WHOLE CREDIT UNION SYSTEM.

ALTHOUGH THE LCCUL PROJECT WAS NOT UNDER STUDY THE CONSULTANTS USED DATA FROM THIS PROJECT TO ILLUSTRATE THE IMPACT OF PRODUCTIVE CREDIT IN BROADER TERMS. WE BELIEVE THAT THE OVERALL PERCEPTIONS OF THE INSTITUTIONAL IMPACTS OF THIS ARE CORRECT. IF ANYTHING, AGAIN THE REPORT IS CAREFUL NOT TO OVERSTATE THE POOR CONDITION OF THESE LOANS OR THE IMPACT AT THE LOCAL LEVEL. THERE IS STILL WIDESPREAD FRUSTRATION AMONGST CREDIT UNION MEMBERS ABOUT THE MANNER IN WHICH PRODUCTIVE CREDIT HAS BEEN DISBURSED. ESTIMATES OF LOAN DELINQUENCY MADE BY THE CONSULTANTS ARE CONSERVATIVE. THE REPORT CITES THE CREDIT ADVISOR'S REPORT (1986) AS SHOWING A 30 PCT DELINQUENCY RATE ON IRRIGATION LOANS MADE SINCE 1986. IN FACT, ALMOST ALL OF THE IRRIGATION LOANS HAD GOTTEN LARGER EVERY YEAR SINCE 1986, AND MOST WERE WELL OVER ONE YEAR BEHIND SCHEDULE. IT IS PROBABLE THAT THE CREDIT UNIONS DID NOT FEEL LIABLE TO THE LCCUL FOR THESE LOANS, AND MANY OF THEM MAY NEVER BE COLLECTED. FROM THE BEGINNING THESE LOANS WERE KNOWN TO BE DONOR FUNDED AND ALTHOUGH CALLED LOANS THEY WERE OFTEN PERCEIVED AS GRANTS AND TREATED ACCORDINGLY BY ALL PARTIES IN THE CREDIT UNION SYSTEM.

OVERALL THE COUNTRY STUDY MAKES A STRONG CASE FOR RECONSIDERING THE STRATEGY OF USING FINANCIAL INTERMEDIARIES AS PASS THROUGH INSTITUTIONS TO DELIVER PRODUCTIVE CREDIT TO SPECIFIC TARGET GROUPS. THE LESOTHO CREDIT UNION SYSTEM PROVIDES MUCH EVIDENCE TO SUPPORT THIS POSITION. THE REPORT DEBUNKS PREVIOUS STUDIES THAT HAVE MISSED THE POINT AND NOT UNDERSTOOD THE PROCESS OF THE DEVELOPMENT OF FINANCIAL MARKETS. IN RETROSPECT, THE STUDY WAS PERHAPS A LITTLE HARSH ON THE ROLE OF THE DONOR AND COULD HAVE PRESENTED A MORQ BALANCED PICTURE BY SHOWING THE OVERALL MALAISE OF THE CREDIT UNION SYSTEM IN A BROADER CONTEXT. FOR YEARS THE INSTITUTIONAL CAPABILITIES OF THE CREDIT UNION SYSTEM HAD BEEN MISJUDGED AND DEVELOPMENT EFFORTS HAD GONE ASTRAY BECAUSE OF THIS AND OTHER ERRONEOUS ASSUMPTIONS ABOUT RURAL FINANCE.

4. SYNTHESIS REPORT: THIS REPORT IS WELL DONE AND NEEDS LITTLE REVISION. HOWEVER, IT COULD BE STRENGTHENED BY INCLUDING THE FOLLOWING POINTS.

SEVERAL TIMES THE REPORT REFERS TO A FARMER'S LACK OF LIQUIDITY AS A CONSTRAINT AS OPPOSED TO A LACK OF CREDIT. WHILE WE AGREE THAT LIQUIDITY IS THE PROBLEM

MORE THAN LACK OF CREDIT PER SE, PERHAPS A BETTER WAY OF EXPRESSING THE POINT WOULD BE TO NOTE THAT FARMERS LACK THE ABILITY TO MANAGE THEIR LIQUIDITY OVER THE AGRICULTURAL CYCLE. THE PAPER CLARIFIES THIS SOMEWHAT WHEN DESCRIBING THE NEED FOR SAVINGS SERVICES BUT THIS MIGHT BE MISINTERPRETED BY SOME READERS.

- THE COUNTRY STUDY DEMONSTRATES THAT THE CREDIT UNION SYSTEM ACTUALLY CONTRACTED RATHER THAN EXPANDED DURING THE PROJECT; THIS DOES NOT COME OUT IN THE SYNTHESIS.

- THE COUNTRY STUDY BRINGS OUT AN IMPORTANT POINT ABOUT THE HEALTHY DEVELOPMENT OF A FINANCIAL INTERMEDIARY, THAT BEING THE FLOW OF RESOURCES FROM THE PERIPHERY TO THE CENTER AND THEN BACK TO THE PERIPHERY CAN OCCUR ONLY WHERE SOLID INVESTMENTS CAN BE MADE IN ENTERPRISES THAT WILL GENERATE SUFFICIENT CASH FLOW TO REPAY THE LOAN PLUS INTEREST. THE AUTHORS POINT OUT THAT PRODUCTIVE CREDIT TO TARGET GROUPS FORCES CASH BACK THROUGH THE SYSTEM AGAINST THE NATURAL FLOW OF THE INSTITUTION. THE SYNTHESIS MAKES THE POINT ABOUT THE NEED FOR MARKETS DEVELOPMENT TO BE DEMAND LED, BUT THE

ABOVE ILLUSTRATION MIGHT BE USEFUL.

A PARTICULARLY STRONG POINT IN THE SYNTHESIS IS THE NEED FOR CREDIT TO BE REAL AND THAT IT SHOULD NOT BE A GRANT UNDER THE GUISE OF A LOAN. THIS UNDERMINES CREDIT DISCIPLINE AND SENDS THE WRONG SIGNALS TO THE MARKET. THE COUNTRY STUDY ILLUSTRATES THE POINT BY INFERRING THAT LOCAL CREDIT UNIONS MAY IN FACT HAVE NEVER CONSIDERED LCCUL ON-LENDING OF DONOR FUNDS AS A REAL LIABILITY. THE CREDIT UNION SYSTEM HAS A LONG EXPERIENCE WITH DONOR PROJECTS AND TENDS TO OPERATE BY THE RULE THAT DONOR LIABILITIES ARE ONLY REAL AS LONG AS THE PROJECT IS ACTIVE; AT THE END OF PROJECT THERE IS NO ENFORCEMENT OF OR ACCOUNTABILITY FOR THE LIABILITY AND HENCE NO REASON TO COLLECT THE LOAN. IT IS APPARENT THAT THE LCCUL HAS TREATED THE SFPC AND LAPIS CREDIT IN THIS MANNER AND MAY ACTUALLY HAVE CONSIDERED THE DISPENSATION OF THESE LOANS AS A (PATRONAGE) GRANT MECHANISM.

OVERALL THE SYNTHESIS IS AN IMPORTANT REPORT THAT SHOULD BE REQUIRED READING FOR ALL PROJECT PLANNERS CONSIDERING CREDIT RELATED PROJECTS. JETER