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1. Background Information

The Spring Review produced a large number of country studies and analytical papers, plus ten regional and country workshops, and culminated in a 2-day Washington conference in July 1973. As you may recall, small farmer credit was selected for study for basically three reasons:

- (1) AID's increasing concern with the employment and income distribution effects of its programs (viz. Policy Determination #48 of October 1972) implies increased concentration on assistance to small farm families;
- (2) in the past, a very significant proportion (about \$55 million a year) of AID agricultural development funds has been devoted to farm credit; and
- (3) the record of small farmer credit programs--in countries where AID has succeeded in participating in such programs--has been disappointing, and much needs to be learned about how to use this tool more successfully.

Although no categorical answers to the small farmer credit problem emerged from the Spring Review process, persuasive evidence of the need for a more comprehensive approach to project and program planning was presented. The Guidelines attempt to provide a conceptual framework for such an approach. Issues are raised within the context of the three categories established for the Spring Review: Role-of-Credit Issues, Policy Issues, and Institutional Issues. The chosen format combines (a) a list of key questions which should be considered in analyzing small farmer credit programs with (b) a brief discussion of the issues raised by each question or set of questions and suggestions as to how one might proceed in answering these questions and (c) relevant references taken from the Spring Review and other materials. A knowledge of basic economic terminology is assumed.

2. Purpose and Use of the "Guidelines"

To put the Guidelines into proper context, two qualifying remarks are in order. First, much of the discussion in the Guidelines is applicable to broader questions of agricultural and rural development for lower income families. In particular, the sections on Program Objectives, Distribution of Credit, Cost Effectiveness, Alternative Delivery Systems, and Monitoring raise issues which are of more general concern. Pending further sector guidance, Missions should take these issues into consideration, as relevant, in designing or evaluating other agricultural and rural development programs.

Second, although we believe the conclusions and recommendations regarding small farmer credit represent a consensus, the conditions under which some of the stated hypotheses are valid have yet to be quantitatively verified. Missions will have to use sample surveys or other information gathering methods to find out more about the specific conditions prevailing among the local small farmer population. During the process, it should be remembered that, in the past, the concept of

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of farm "viability" has been too narrowly defined; in fact, technicians have on occasion eliminated the small farmer category¹ entirely as "non-viable". Recent evidence shows both that per hectare productivity on small farms is often higher than on large farms and that small farmers have high marginal savings rates, especially when profitable investment opportunities exist. Missions should examine critically the assumption that any particular category of farmers is unable to sustain a development effort. Furthermore, as an aid to programming, Missions may wish to assist countries which do not already possess such information to develop a small farmer "profile" with information on number, type, and location of all small farmers attempting to identify programs which would respond to their development needs. This might be done as a part of a broader attempt to develop a "profile" of the rural poor for use by the recipient government and AID in designing programs and strategies aimed at rural poverty.

Mission management -- as well as loan officers, Food and Agriculture Officers, Program Officers and other relevant AID or host country personnel involved in small farmer credit program design, evaluation or administration -- should be informed concerning the serious questions raised in the Guidelines about some of the policies frequently followed in agricultural credit programs. Missions will be expected to show a concern for the issues raised in future communications and documentation, although the degree of treatment of each issue will depend on its saliency within the individual country context. Each Mission proposal should, however, address explicitly the question of economic efficiency² -- in terms of both alternative credit programs designs and alternative uses of the funds for assisting small farmers or, more broadly, the rural poor. An explicit treatment of alternatives need not entail precise quantitative estimates but should demonstrate that serious inquiry into alternative strategies has been made. In addition, Missions should attempt to compute expected costs and benefits of the proposed program both (a) to small farmers and (b) to the government.³ Although computation of costs (including delinquency and default) and return (i.e., margins on lending and repayments) from the point of view of the government may show that a subsidy is required,

- 1/ See Section II A of the Guidelines for a discussion of the definition of small farmer.
- 2/ As used in this airgram economic efficiency means both that social benefits of a given activity outweigh its social costs and that there are no feasible alternatives with lower cost/benefit ratios which would accomplish basically the same objectives.
- 3/ It should be recognized that uncertainty concerning availability of fertilizer will make profitability calculations even more difficult than in the past. Also, high future prices will cause substitution of other inputs for fertilizer and may depress the demand for small farmer credit in programs where credit is tied to a limited number of inputs including fertilizer.

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Mission analyses and project justifications should show that costs have been minimized and returns have been maximized as consistent with program objectives; where subsidies - even though temporary - are required, justification in terms of alternate uses of funds to reach target groups, of time period for which subsidy will be required and of the extent to which credit is likely to be a major constraint on small farmer output becomes particularly relevant. Where feasible, national economic and social effects of proposed programs should be quantified in a cost/benefit analysis; however, we recognize that in many cases this will not be feasible, as data may not be available or key issues may not be quantifiable.

3. Summary of Conclusions and Recommendations Contained in the "Guidelines"

Objectives of small farmer credit programs are not always clearly stated nor are they always consistent. Depending on pricing and other policies, efficiency and equity objectives may or may not be mutually obtainable. AID's objective is to assist the lower income groups; therefore, credit and other agricultural assistance programs should be oriented toward the small farmer group. However, credit may not be the best form of assistance for this group; if the small farmer does not make a clear profit from the use of credit, the credit program is highly unlikely to succeed. Missions should keep the following points in mind when deciding on the appropriateness of instituting or maintaining a small farmer credit program (these are the Role-of Credit Issues):

i. Credit is no panacea for the problems of the small farmer. Providing credit will not lead to an increase in output or net income unless a series of conditions are met, the most important of which is that profitable investment opportunities exist. Opportunities for profitable credit utilization probably exist for some farmers in all countries, but they may not be widespread. Prior to funding a credit program, great care should be taken in both area and target group selection to insure that the essential investment opportunities are indeed readily and practically available to the small farmer. Attention should be focussed on whether production credit is required or whether marketing credit or consumer credit is the farmer's major financial constraint.

ii. The absence of a new technology, rather than credit, is the effective constraint on increased production for small farmers in many areas. In other areas, the lack of information or essential marketing or input-supply services or land distribution may be the major obstacles. The development program should be tailored to a given region's problems. Often credit may need to be accompanied by one or more other programs or policy changes which address bottleneck constraints on small-farmer production, if the credit program is to be effective.

iii. Before deciding on the appropriateness of a credit program, consideration should be given to (a) whether local cultural and risk-aversion factors may prevent farmers from responding satisfactorily; and (b) whether adequate funds are already available from existing savings capacity and

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savings mechanisms (e.g., mutual savings societies) and from alternative sources of loan funds, namely the "informal" credit market, at not unreasonable terms.

iv. During the course of the Spring Review, programs with subsidized interest rates or high default rates were sometimes justified as a form of "welfare" transfer to the poor. In general, however, the distribution of such "welfare" transfers is (at least) as highly skewed -- against the small farmer and, by definition, against the landless poor -- as the distribution of government small farmer credit; it thus becomes difficult to defend subsidies and defaults from a "welfare" point of view. This is particularly true when one considers alternative programs, in health or education for example, which can be more easily targeted, which may well have a higher impact on productivity, and which may be established at a lower per-family cost than the cost of loan defaults.

Once it has been determined that credit is in fact an appropriate form of assistance, the program design should reflect the following considerations (these are the Policy and Institutional Issues):

i. Existing agricultural credit agencies tend to channel the majority of available lending capital to medium and large size farmers. Small farmers are generally not the major beneficiaries even when programs are specifically targeted for them (unless the definition of small farmer is so loose that it includes landholders in the upper deciles of the income distribution). In many cases, the reasons for the inequitable distribution are political or administrative. To resolve the former, the political will of the government must be changed. There is a limit to what foreign donors can appropriately do in such situations, other than assist in studying and illuminating the problems, support government steps in the right directions, or withhold assistance. Problems which are primarily administrative are more tractable but require an imaginative restructuring of incentives and an elimination of many conventions imposed by bureaucratic tradition.

ii. With few exceptions, it has been noted that costs exceed revenue in public small-farmer credit programs and program continuance depends upon government subsidies. If these programs are to continue and expand, institutional revenue can and should be increased by raising interest rates to levels commensurate with real costs, which can also be reduced through both lower administrative expense and lower default. Subsidies may still be required if these can be justified in terms of alternate uses of scarce government revenues, but such subsidies should be relatively smaller and hence more easily justified. It has also been noted that weak administration characterizes most credit programs. Especially at the local level, field office administration of national banks or cooperatives is thin, often of poor quality, and equally poorly adapted to the specific needs of the small farmer. Good credit programs are invariably decentralized, but more attention must be focussed on strengthening credit administration and structuring

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it more rigorously to meet the needs of small farmers.

iii. Raising interest rates to "market" levels has several additional advantages beyond raising revenues of credit institutions. By making capital more expensive, higher interest rates tend to encourage more labor intensive techniques, and hence more rural employment. Also, a higher interest rate will both increase the total supply of loanable funds and make it uneconomical for some large farmers to borrow. Both of these effects should work to give small farmers with profitable investment opportunities greater access to credit funds.

Interest rates can be directly subsidized by lending to small farmers at rates below commercial rates or indirectly subsidized by regulations placing ceilings on all commercial lending and deposit rates. However, in either case the small farmer tends to get less of the credit available than if rates were higher. It is more profitable for private or public lenders to lend to larger farmers, since small loans have higher administrative costs, and large farmers have more assets to offer as security. Also, it can be expected, whenever subsidized agricultural credit is available, the economically and politically powerful (in this case the larger farmers) often capture the funds, whether for investment on their farms or for investment at higher "market" rates in the cities.

iv. Credit can be delivered through alternative public and private institutional forms. Each mechanism has certain advantages, and none can be considered superior in all situations. Poor management was a problem common to all the mechanisms analyzed. Although the appropriate conditions and timing of credit group formation vary, some kind of group approach seems to be essential to lowering costs of public small farmer credit programs both through: (a) economies of scale to the lender in loan administration and (b) increased social pressure of the group for individual repayment thereby reducing default rates. Where appropriate alternative distribution systems should be tested on a pilot basis at the local level to determine which is most cost effective under local conditions.

v. Insufficient attention has been given in analysis of small farmer capital requirements to the role of "informal" credit. Money-lenders are widely reviled as economically and politically exploitative. On the other hand, from the point of view of small farmers as a whole, the timely availability of funds easily obtained - even at extremely high interest rates - may be of critical importance. In many situations there are constructive steps which can be taken to increase the supply of funds to, and competition among, "informal" lenders to small farmers such as changing administrative regulations to improve the access of "informal" lenders to organized money markets, instituting refinance programs for credit extended to small farmers by input suppliers, and allowing banks or others to set up small farmer lending firms which (like the U.S. consumer loan industry) can legally charge significantly higher rates than commercial banks. With such steps not only might

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there be more lending to small farmers, but the increased competition should reduce the cost of credit and the monopolistic exploitation of the village money lender.

vi. There seems to be considerable benefit to be gained through the linking of savings and credit in the mind of the small farmer. Whether a savings program should be directly linked to a credit program depends in part on the nature of alternative institutional or non-institutional savings mechanisms. In many cases, a voluntary savings capacity does exist and if savings mechanisms are not available, a savings mobilization and reinvestment program might be fostered at little expense to the government.

vii All credit agencies should attempt to monitor and evaluate their programs to test the degree to which they are meeting objectives and to identify opportunities for management improvement. Such evaluation should consider the kinds of issues raised above as well as internal institutional and financial objectives, and in particular the institution's effectiveness in reaching small farmers.

4. Baseline Survey and Agricultural Credit Policies

As part of its follow-up program on the Spring Review, AID/W conducted an informal policy baseline survey of 8 on-going AID-supported agricultural credit programs (4 in L.A., 3 in Asia, and 1 in Africa) to get some idea of the nature of the programs currently supported and their compatibility with the recommendations that have emerged from the Spring Review. A summary of the responses given to some 14 questions are given below. These responses may be of some interest to USAIDs when considered in light of the recommendations contained in the attached Guidelines. As you will note, recommendations regarding interest rates, institutionalized evaluation, integration of savings program and marketing services into the credit program and graduation policies are in general not currently followed. Most programs, however, are currently experimenting with group credit, integration of extension services (and to a lesser extent research), and profitability calculations.

Although the 8 credit programs investigated were nominally programs designed to assist small farmers, it appears that those served are primarily upper-level small and medium farmers. In general, program goals (e.g., production vs. equity) are clearly stated but often not specific enough to be operationally useful. Target farmers often are identified by farm size, geographic location or type of technology (e.g., irrigation), and credit groups are used in 5 out of the 8 programs. In 6 out of 8 programs profitability calculations have been made on the basis of sample field tests, a production model, or individual farm investment plans; and, in most cases, credit is tied to specific crops and/or inputs. In half of the programs credit is provided exclusively for short term production or marketing purposes, and in the other half some medium term credit is available. In 7 out of 8 cases, interest rates range from 6 to 12 per cent, and in one case - where there is a high rate of inflation - interest rates are 23 - 25 per cent. Savings facilities

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are normally provided by agricultural credit institutions but are not usually an integral part of the credit system. Often, too, the incentive system to save is weak. Extension services are normally built-in to the program either directly or through cooperative arrangements with other institutions, but coordination with research institutions is less explicit. In most cases, there is no "graduation" policy (see attached Guidelines), no institutionalized evaluation system, and no effort to harness private capital.⁴

5. Proposed GTS Contract with Ohio State University

In connection with these Guidelines, we would like to inform Missions of a new TAB-sponsored GTS contract which is under negotiation with Ohio State University (OSU) as part of a follow-up program to the Spring Review on Small Farmer Credit. The proposed contract covers the period July 1, 1974 to December 30, 1975, and provides support for a quarterly newsletter (to be called "Research and Policy Notes on Agricultural Credit"), several regional seminars or workshops on specific aspects of small farmer credit, and a small amount of seed capital for LDC-based research projects. OSU will also assist in locating qualified consultants for small farmer credit program design and evaluation as required and requested by USAIDS. (Existing GTS contracts can also be used for this purpose.) More specific details of the OSU contract will be forwarded to USAIDS when contract terms are finalized.

6. Comments from Missions

Whereas this message concentrates on substantive issues, we recognize that there are significant programming constraints on any small farmer development project, including (a) a need for comprehensive project design/analysis expertise, particularly where "role" and "policy" issues, as well as "institutional" issues are highly salient and (b) a need for a larger ratio of local currency to foreign exchange assistance. We have no ready solutions for these constraints that would not be already obvious to Missions, but we can give assurances that attempts to concentrate an increasing amount of assistance on the poor within the LDCs - whether through small farmer or other rural development projects - will receive priority attention and support. Formal or informal comments from Missions regarding either the substance or the programmatic implications of the Guidelines are welcome.

^{4/} For a summary assessment of the characteristics of a larger sample (17) of current AID and non-AID small farmer credit programs, see "A Typology of Small Farmer Credit Programs" by Antonio Gayoso in AID Spring Review of Small Farmer Credit, Volume XII; and, for an historical description of AID financed programs in agricultural credit, see AID Spring Review of Small Farmer Credit, Volume XVIII (also issued as Evaluation Paper 6).

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A.I.D. GUIDELINES
ON
PROJECT AND PROGRAM PLANNING FOR
SMALL FARMER CREDIT

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GUIDELINES ON
PROJECT AND PROGRAM PLANNING FOR
SMALL FARMER CREDIT

The Guidelines attempt to summarize our present knowledge about small farmer credit programs drawing heavily on lessons learned during the course of the AID 1972-73 Spring Review of Small Farmer Credit. Treatment of the major issues in the Guidelines, as in the Spring Review, is basically market-oriented, although references to social and political forces are made where their influences are believed to be particularly strong. The format follows the Spring Review distinction between (a) issues concerning the role of credit, (b) policy issues and (c) institutional issues. Each sub-heading starts out with a question or set of questions designed to focus attention on the issue(s) concerned; the questions are followed by a brief discussion of the topic with suggestions on how to obtain relevant material and information from the Spring Review and other sources. Policy guidance is introduced where appropriate.

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CAPTIONS

ACCRA FOR USAID AND RPO

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I. ROLE-OF-CREDIT ISSUES

A. Program Objectives

- Questions:
- What are the program objectives? Are they conflicting or consistent?
 - Are there alternative, more cost-effective ways of achieving these same objectives?
 - Do the estimated benefits from the program outweigh the opportunity cost of funds?

Program objectives normally fall into one of two categories: efficiency and equity. Efficiency objectives demand (a) the efficient allocation of resources among competing uses and (b) cost minimization in program implementation.¹ Equity objectives demand that the benefits of a given program be "equitably" distributed among the population. The benefits may be in terms of increased employment, increased access to government services, or increased net income; however, the last measure is probably the most comprehensive, as it depends in part on the presence of the first two. Of course, governments, as well as individuals,

^{1/} Efficiency objectives are normally associated with the production process - i.e., what is the most efficient process for producing a given output; however other concerns, for example, the balance of payments, can also be handled. To the extent that foreign exchange is valued highly by the economy, economic efficiency will involve minimizing program imports and maximizing program exports.

may have varying concepts of what "equitable" means and how much importance it should be given relative to efficiency objectives.

AID has an overall equity objective (viz. Policy Determination #48 on Employment and Income Distribution Objectives), associated with agricultural credit programs, namely increased net income for small farmers. (The problem of defining "small farmer" is discussed in Section II A below). To achieve this objective, assistance must be restricted to small farmers as a target group, and yet this restriction must take place in a manner consistent with the LDC's national priorities. Once the target group has been selected, the primary objective becomes efficiency. This means considering (a) whether there are alternative, more cost-effective ways of achieving the objective of increased net income for small farmers and (b) whether there are alternative, more efficient credit program designs.

An approach to identifying a target group and establishing program objectives might, therefore, involve the following steps:

- 1) Identification of the scope and nature of the small farmer problem countrywide;
- 2) Review of the LDC's national strategy and how small farmer assistance fits into this strategy;

- 3) Selection of a target group using such criteria as geographic location, income level, viability as determined by resource base, nature of farming enterprise or potential for diversification;
- 4) Preliminary assessment of the social and political as well as the economic feasibility of proposed program;
- 5) Collection of existing data and where necessary, new data through sample surveys; (Note here that data other than those that bear directly on the target group might also be useful in subsequent analysis.)
- 6) Data analysis and project design (to include consideration of alternative projects/designs to achieve same objective).

Often, of course, AID is asked to support or continue to support an on-going credit program. In this case, many of the above considerations will have been already addressed; however, a redefinition of program objectives may be required. Small farmer credit program objectives are not always clearly identified or, when multiple, ranked in order of priority. In some cases, program objectives may be political with no clearly specified equity or efficiency concerns. Furthermore, implementation strategy

for programs with both efficiency and equity goals can be ambiguous unless these goals are mutually consistent. Recent studies showing that the return on capital investment in small farms is high compared to investment in large farms demonstrate that efficiency and equity goals can be complementary; however, where price distortions - especially the underpricing of capital and the overpricing of labor - are serious, these complementarities may not exist. In such cases, a change in policies is required.

Where conflicts do exist, it is sometimes useful to try to quantify the trade-off between alternative benefits of two or more fixed cost programs. For example, one might want to compare the production and equity benefits between a labor-intensive and a capital-intensive production technique (or between a heavily supervised and a lightly supervised credit program). The trade-off concept is useful; however, two caveats should be mentioned. One is that comparisons of program benefits must be judgmental to some degree since such features as increased access on the part of the poor may have political, social, and psychological benefits which are not captured in quantitative measures. The other is that the existence of factor price distortions imply

that the trade-off arrived at through financial calculus may be more illusory than real.

- References: (1) "The Trouble with Goals of Small Farmer Credit Programs" by Judith Tendler, AID Spring Review of Small Farmer Credit, Volume XIX, 24 pp.
- (2) "Partial Implications of the Linear Programming Analysis for Decision-Making in the Agricultural Sector," Analytical Working Document #6 of Colombia Agriculture Sector Analysis (AID-IA/DR/SAS). (Illustrative measurement of trade-offs associated with alternative strategies).

B. Characteristics of the Small Farmer in Traditional Agriculture

- Questions:
- What local cultural and/or risk-aversion factors may prevent small farmers from responding satisfactorily to the credit program? How can these be overcome?
 - What is the form of savings prevalent in the countryside and how can these savings be tapped and increased for re-investment in productive activities?
 - What are the nature, scope, and cost of credit in the informal money market in the rural areas?

Out of the Spring Review came a restatement of the situation of small farmers in traditional agriculture. This can be summarized in three general propositions which may run contrary to views held in some countries. Although these generalizations do not hold in all situations, they are supported by most of the authori-

ties with extensive field experience as well as by relevant available data. They should be used as working hypotheses in formulating credit programs unless specific country evidence is available to support an alternative set of key assumptions.

The propositions can be stated as follows:

- 1) On the whole, small farmers are rational and well informed about traditional agricultural technology. Cultural factors and risk aversion may inhibit their adoption of new technologies to their economic advantage, but they normally maximise their returns from traditional technology.
- 2) Within limits, small farmers are willing and able to save. A shortage of capital, is likely to constrain few farmers from adopting some feature of their traditional technology. The rate of savings is often low in the countryside, not because farmers are unwilling or unable to save, but because farmers using traditional technology have over time accumulated the capital commensurate with patterns of landholding, labor, and management requiring relatively low capital inputs. Because their savings performance has been

modest - for the above mentioned reasons - small farmers often cannot immediately take advantage of a new, more capital-intensive technology.

- 3) In Asia, the Middle East, Latin America, and to a lesser extent sub-Sahara Africa, there are informal lenders from whom small farmers can borrow at least for short periods. One of the major sources of funds are friends and relatives who sometimes charge little or no interest. Though rates from commercial lenders are much higher - reaching and sometimes exceeding four per cent per month - the difference between these rates and institutional rates are not necessarily a measure of exploitation. Costs of lending are very high in rural credit. Some exploitation undoubtedly exists, but exploitation is not necessarily the major reason rural interest rates are high.

The implications of these propositions are obvious and of great importance for credit programs: The absence of institutional credit may not at present be an important constraint on increasing production using traditional methods. Nor may it be an important constraint for small farmers wishing to adopt a new technology

which requires little additional capital. Other factors such as technical knowledge, input supply, or land holdings constituting less than an "economic unit" may be the effective constraints. Public credit programs should be designed to meet the needs of farmers who can productively use additional capital but who are genuinely unable to finance their needs through savings and borrowing from other sources.

In attempts to determine the real need or demand for institutional credit for small farmers, local institutions, rural sociologists, agricultural extension agents or community development workers may provide valuable insight. In addition, it may be highly desirable to conduct a small, appropriately designed rural sample survey to obtain more specific information on facts and attitudes. This could be arranged locally with the central statistical office or, by contract, with a private firm, university or other source.

- References: (1) "The Credit Connection: Cultural and Social Factors Affecting Small Farmer Participation in Credit Programs" by Cynthia Gillette and Norman Uphoff, AID Spring Review of Small Farmer Credit, Volume XIX, 39 pp.
- (2) "The Case for Voluntary Savings Mobilization: Why Rural Capital Markets Flounder" by Dale W. Adams, AID Spring Review on Small Farmer Credit, Volume XIX, 16 pp.

- (3) "Regional Similarities and Differences in Small Farmer Credit" by Marvin Miracle, AID Spring Review of Small Farmer Credit, Volume XIX, 13 pp.

C. Conditions for the Productive Use of Credit

- Questions:
- What type of credit is required - production, marketing, or consumer?
 - Are profitable small farmer technologies available? Are these effectively communicated to participants in the credit program?
 - Is there satisfactory handling of agricultural inputs and outputs for the small farmer under present conditions? If not, what modifications are necessary as conditions for success?
 - What is the effect of land tenure patterns and other socio-political characteristics on profitability and incentives?
 - How might cultural attitudes toward innovation and risk affect the program?

Credit will contribute to increased output only under a limited set of conditions. First, it must be ascertained whether production credit, as distinguished from marketing credit or consumer credit, is required. The type of credit required will be an important determinant of the appropriate delivery system. Furthermore, if production credit is required, there must be an opportunity for farmers to make what is for them a profitable investment.

Examples of such opportunities are: the introduction of a new technology, e.g., high-yielding seeds or fertilizer; the opening of new land areas, the introduction of a new cash crop to the region, and crop intensification or crop saving practices. It should not be assumed that profitable investments for the farmer exist.² In fact, the evidence is to the contrary: the preponderance of unsuccessful credit programs for small farmers have failed for precisely this reason - there was no feasible way in which the farmers could profitably invest the credit extended to them. Either there was no new (i.e., new to that farmer) applicable technology; or if the technology was applicable, farmers were constrained by one of the following economic or social conditions:

1. Even where technical opportunities exist, they may not be economic. New grain varieties, although they may produce a larger harvest in physical terms, have sometimes sold at a discount because local consumers considered them inferior to native grains. The pro-

^{2/} In order to consider an investment opportunity as profitable small farmers may require a substantial financial profit rate, i.e., 30-50 per cent or more depending on their risk-aversion.

fitability of new investment opportunities resulting from new technologies or from the opening of new lands clearly is not guaranteed, and it would be naive to assume that all new technology made available to the small farmer would be profitable to him.

2. Some of the recent improvements in technology involve indivisible components which make them less suited for adoption where farming units are small. For example, the new seed varieties are much more productive when water application can be controlled, yet the minimum size tubewell or low lift pump available in most areas is far larger than required by small farmers to irrigate their land. (The availability of long-term as well as short-term credit constitutes a necessary but insufficient response to the problem of indivisible components.)
3. Many agricultural innovations are quite risky. For example, the new seeds show greater yield variation than the varieties they displace. Under ideal conditions output may be twice as great or more, but under adverse weather conditions the new seeds may yield even less than the traditional varieties. Many of the

- traditional varieties have evolved over time to produce under wide extremes of harsh conditions and to resist local diseases. Among small farmers living in marginal ecological areas or close to subsistence levels, the risks associated with the technologies may jeopardize survival, and thus substantially reduce the attractiveness of new practices.
4. A number of country studies show that a lack of adequate infrastructure makes marketing costs unduly high. In addition, pricing policies, such as an overvalued exchange rate, export duties, or ceilings on agricultural prices designed to favor urban consumers, may impede farmers from profitably marketing additional output.
 5. Adoption of the new practices may be constrained by poor input supply. For example, new seeds and pesticides may be available, but fertilizer may be in short supply. Because the success of the new technologies depends on a balanced application of several inputs, the absence of any one may affect adversely the benefits from using the others. The small farmer is at a definite disadvantage in obtaining essential

inputs if their supply is limited. A strong association exists in most countries between wealth and power; as a result, scarce inputs, are sold primarily to the wealthier and more influential farmers.

6. Farmers may be ignorant of new economic opportunities open to them, or they may misjudge the potential return. In many cases recommended practices appear to be only imperfectly adopted. Farmers may use new seed but not fertilizer; or use fertilizer on seed beds but not on the fields. An educative process may be needed with regard to the potential profitability of innovation. For various reasons, including the great effort required to reach large numbers of small farmers, extension agents spend less time visiting small farmers, and thus the latter have reduced access to one of the main sources of information regarding new practices.
7. New agricultural practices may disturb traditions, attitudes and values. Profitable changes in practices may not be adopted if they involve work considered to be demeaning, or if agriculture is only a secondary occupation with primary orientation toward non-agricultural employment, as in parts of Africa, or if

societies provide sanctions against progressive farmers. In other words, cultural factors may make farmers unwilling to adopt new practices even when all the economic conditions are met.

8. Land tenure patterns - especially tenancy arrangements, unusually small holdings, and severe fragmentation - may reduce the profitability and therefore the incentive to adopt new technologies or even improved practices.
9. The absence of purchasable consumer goods in remote areas may detract from farmers' incentives associated with increased income.

As the above discussion shows, profitability depends not only on production technology and market prices but also on a complex set of other factors. Each of these factors should be addressed in designing or evaluating a small farmer credit program, and Missions may require outside consultant assistance in pulling all the pieces together.

References: (1) "Conditions for Success of Public Credit Programs for Small Farmers" by Millard Long, AID Spring Review of Small Farmer Credit, Volume XIX, 15 pp.

- (2) "Role of Credit in the Economic Development of Small Farm Agriculture" by Chester Baker, AID Spring Review of Small Farmer Credit, Volume XIX, 27 pp.
- (3) "Technology, Profit and Agricultural Credit" by Ronald Tinnermeier, AID Spring Review of Small Farmer Credit, Volume XIX, 16 pp.

II. POLICY ISSUES

A. Distribution of Credit

- Question:
- What is the present pattern of distribution of agricultural credit with regard to low, medium, and high income farmer groups?
 - What are the political, economic, technological and administrative constraints on credit distribution to small farmers? What changes are necessary to increase credit for small farmers?

To date credit institutions have made little credit available to small farmers. Even those programs set up to serve small farmers usually lend most of their funds to farmers who fall outside the target group. Some agencies make numerous loans to small farmers but these are of small size; in value terms the loans go to larger farmers.

The reasons for the failure to reach small farmers even when they constitute the target group are several. Many credit institutions, at both the national and the local level, face political and administrative pressures to lend to the larger farmer. It is the large farmer who the credit officer knows personally. Moreover, with limited personnel, an institution is restricted in the number of loans it can process. Finally, to maintain the financial viability of the institution and to keep costs down,

it is easier to make loans to the larger farmers. These are all important problems which must be resolved if the objective of supplying credit to small farmers is to be met. (For suggestions regarding the reduction of these problems, see especially sections II B, II E, and III A below.) As distribution policy is crucial, Missions should seek facts on both past distribution and policy for the future as a first priority.

It is now established AID policy to concentrate support of agricultural credit programs on small farmers. Missions can provide funds either to programs which lend exclusively to small farmers or to institutions which have small farmer credit programs so long as in the latter case the total amount of increased lending (i.e., AID funds plus increased local contributions) to small farmers will be at least as great as the funding to be supplied by AID. The latter formulation provides slightly more flexibility in programming and reduces somewhat the pressure on AID for local currency funding, which is likely to constitute a larger percentage of small farmer credit programs than of agricultural credit programs in general.

The intent of this policy prescription, which arises primarily out of the Agency's concern with the equity impact of AID sup-

ported programs (viz. AID Policy Determination #48 of October 1972), is clear; however, ambiguities arise in the attempt to define "small farmer." In a draft policy paper in agriculture credit, the World Bank has defined a small farmer as having less than 5 hectares of land, or in countries where the majority of the farmers have less than 5 hectares, the 50 percent with the lowest income. Although this definition may be a good general reference point, the quality of land and its development potential vary. Thus, farm size may or may not be a good proxy indicator for the small farmer category. No adequate, globally acceptable definition of small farmer has in fact been devised, although such indicators as (a) net income, (b) net assets, (c) accessibility, (d) nature of technology, as well as (e) farm size have been used to establish a small farmer category in any given country or region. In general, one can say that a small farmer is one whose net income and/or assets are low both in absolute terms and relative to other farmers in the sector; and, as a rule of thumb, since data on assets are difficult to come by, one might simply define the relevant net income category to include farmers with incomes equal to the mean (or average) rural

family income or less.³ Since upper income groups give a positive skew to the distribution of income (i.e., making the average higher than it would be if incomes were more equal), this definition will probably include a majority of all farm families.

Although the net income and/or net asset concept appears to be the most comprehensive, Missions and LDC country programs may choose to define the small farmer group using other criteria such as geographic region, type of tenure, crop, or farm size as proxy indicators of low income. Thus, an alternative, and perhaps more easily verifiable, policy definition of small farmers might include farmers whose holdings are smaller than a given size (e.g., 5 hectares) and who have not previously had access to government institutional services. In the event that average rural net income is not used to define the upper limit of a small farmer category, however, some effort should be made to define the range of possible income groups involved.

References: (1) "Technical Change and the Distribution of Income in Rural Areas" by Carl Gotsch, American

3/ Average rural income is used here to suggest an upper limit on eligibility. A lower limit on eligibility would depend more directly on the credit-worthiness of the individual applicant. If the group of credit-worthy applicants is small, it is probable that credit is not the primary constraint on increased incomes.

Journal of Agricultural Economics, Volume 44,
No. 2 (May 1972) 15 pp.

- (2) "The Distribution of Agricultural Credit and Benefits: Political Economy and Small Farmers in Less Developed Countries" by Harry Blair, AID Spring Review of Small Farmer Credit, Volume XIX, 12 pp.
- (3) "Employment and Income Distribution Objectives for AID Programs and Policies: by Edwin Cohn and John Eriksson, AID Policy Background Paper (October 1972), 45 pp.

B. Interest Rates

- Questions:
- What is the present interest rate structure in the country? Are interest rates high enough to cover the operational costs of credit without depressing the level of participant investment?
 - What interest rates do small farmers face in the informal market? Do these rates represent monopoly profit or real costs?
 - What lending margins are necessary for capitalization of various agents in the lending chain, especially if private sector institutions are involved?

Conceptually, one can distinguish four types of costs which should be covered by the interest rate on agricultural credit loans:

(1) the opportunity cost of capital, i.e., the average return on investment in the economy at large; (2) the institutional overhead costs associated with administering the loan; (3) a premium for the risk of delinquency or default; and (4) a premium to cover the rate of inflation.

Some of the experts at the Spring Review felt that raising interest rates substantially is the single most important change that has to be made in credit programs. As long as resources are scarce, it is argued, they should be rationed to those who can use them most productively; and recent evidence shows that the productivity of capital on small farms is often quite high. Furthermore, it

is said, higher rates would mean more credit for small farmers by making lending more profitable and retarding the decapitalization process that often occurs over time with small farmer credit programs. When rates are low, institutions can not afford to lend to small farmers. Also, only by charging higher rates on loans can institutions afford to pay more on deposits. The latter is considered essential to mobilize savings, which credit institutions must do eventually if they are not to be forever dependent on government loans and grants. (See Section II E below). In addition, some experts believe that repayment rates improve if members have a stake in the institution through savings or equity participation.

The arguments for high interest rates were not supported by all of the experts; resistance and counter arguments were put forward by AID field personnel and LDC credit administrators in the regional seminars. Part of the problem with raising interest rates for small farmers is that the whole structure of interest rates is too low, so that raising rates for small farmers to cover the real costs of lending will discriminate against them unfairly. This is, of course, true, but it is also true that present rates would have to be tripled or quadrupled before real costs were covered. Perhaps the most often articulated objection

was that low rates are needed to stimulate investment by small farmers who can not afford higher rates. In fact, however, a low interest rate is often perpetuated as political tokenism to the poor in a program whose coverage is so limited that the subsidized costs are still bearable by the government. In other words, low interest rates are claimed as a pro-poor policy but the effect is to severely restrict the availability of funds and hence participation of the poor in the program. From the farmer's point of view, when there is an opportunity for productive investment, ready availability of capital is likely to be more important than price. Also, and paradoxically, higher official deposit interest rates, by increasing savings, may force down informal rates.

It is true that small farmers may require subsidies; however, these subsidies should be given in the form of services (such as extension, some of the credit institution's administrative costs, or roads into poor areas) that are not easily transferred from one individual to another. Subsidized physical inputs such as fertilizer often end up in the hands of individuals who were not meant to receive the subsidy. Similarly, subsidized interest rates for small farmers, which are less than other institutional lending rates, almost always discriminate against

the weak in favor of their more powerful neighbors. Also, subsidies on selected inputs tend to distort relative real factor prices. In the case of an interest rate subsidy, the latter implies the underpricing of capital and hence an artificial incentive to substitute capital for labor, an undesirable phenomenon in a labor-abundant, capital-scarce economy.

Today, in many programs, interest rates are negligible or even negative in real terms, that is after correcting nominal rates for inflation. Such low rates are economically unjustifiable, and AID/Washington believes strongly that in most programs interest rates should be higher. A reasonable initial target might be to raise the interest charge to 12 - 15 percent in real terms, that is to raise the rate to 12 - 15 percent plus the going rate of inflation.

- References:
- (1) "Interest Rate Policies and Small Farmer Credit Programs in LDCs," by Claudio Gonzales-Vega, AID Spring Review for Small Farmer Credit, Volume XIX, 35 pp.
 - (2) "Higher Interest Rates Reconsidered" by Millard Long, AID Spring Review of Small Farmer Credit, Volume XIX, 2 pp.
 - (3) "The Interest Rate Policy for Agriculture in Developing Countries: The Prescription versus the Experience" by Charles Nisbet, AID Spring

Review of Small Farmer Credit, Volume XVI, 18 pp.

- (4) "Agricultural Credit Policy in Developing Countries" by Jirysis Oweis, AID Spring Review of Small Farmer Credit, Volume XVI, 54 pp.
- (5) "The Structure of Interest Rates in Underdeveloped Rural Areas" by Anthony Bottomley, Journal of Farm Economics (May 1964).
- (6) "A Model of Credit Applied to the Allocation of a Sample of Mexican Farms" by Jerry Ladmon, in Economic Development and Cultural Change (January 1974).
- (7) Money and Capital in Economic Development by Ronald McKinnon (1973).
- (8) Financial Deepening in Economic Development by Edward S. Shaw (1973).

C. Default and Delinquency

- Questions: - What is the extent of default and delinquency in on-going agricultural credit programs?
- What is the reason for default/delinquency? What must be done to reduce the default/delinquency problem?

The demise of agricultural credit institutions is often brought about by high rates of default. Until the day of reckoning most credit agencies conceal their usually poor repayment picture through rescheduling overdue loans and reporting inappropriate statistics; however, few public credit agencies seem in fact to have delinquency rates below 40 percent. These institutions are not financially viable; the credit agency should not treat rescheduled loans as though they had been repaid. In dealing with credit agencies with on-going programs, care should be taken to ascertain the actual delinquency situation. Perhaps the best single measure of delinquency in a credit program would be annual figures showing the percentage of overdue loans plus interest actually paid during the year.

There are various reasons for non-repayment; the harvest may have been poor, the farmer may simply refuse to repay because he knows the stated transactions will not be applied, or the money may have been spent on consumption rather than production. It

has also been suggested that default may be associated with poor quality extension. AID Missions should: (a) attempt to learn the truth about repayments; (b) ascertain as well as possible the reasons for non-repayment when the figure is high; (c) work out with the agency a program for improving performance; (d) develop a system to monitor performance. The funds lost through delinquency and default have high opportunity cost particularly when these losses are made up from public funds. Also the distribution of income through default tends to be regressive, even where the bulk of the loan money is going primarily to the larger among the small farmers, not to mention when loans are extended primarily to medium and larger farmers.

References: (1) "The Credit Connection: Cultural and Social Factors Affecting Small Farmer Participation in Credit Programs" by Cynthia Gillette and Norman Uphoff, AID Spring Review of Small Farmer Credit, Volume XIX, 33 pp.

D. Supervision

- Questions: - What elements of supervision are essential to the success of the program and what elements can be eliminated in order to lower costs?
- What other institutional mechanisms to incentives can be introduced to achieve the objective normally associated with supervision?

To prevent misuse of agricultural credit funds (due to inadequate technical knowledge, poor management, or diversion of funds for consumption purposes) and to help contain the high delinquency rate which plagues most programs, many agencies have established supervised credit programs for small farmers. The degree of supervision covers the entire gamut from the simple provision of information coupled with credit; to the specification of inputs the farmer should employ, which may then be provided in kind; to the almost complete control of the farm operation by the supervising officer. Each added degree of supervision is, of course, more costly.

To the extent that supervision provides the farmer useful information, it is probably an effective complement to credit. But to use supervision to force farmers to utilize funds as dictated by the credit agency may be counter-productive. Too much super-

vision is likely to be considered unwarrantable interference by the farmer, who may then become alienated from the credit institution. Group dynamics and the development of self-monitoring skills on the part of the farmers are also important. Furthermore, experience shows that credit, whether in cash or kind, is simply too fungible for an institution to be able to control effectively how it will be used by farmers. It is impossible and perhaps undesirable to eliminate completely the use of credit for consumption purposes. In Section I B above, the working hypothesis that small farmers are essentially rational is presented. It follows that if farmers are convinced of the profitability of a new opportunity they will use the loan for investment purposes. Thus, restricting credit to production areas with bona fide investment opportunities is essential to reduce the misuse of funds. Otherwise, the question of supervision for small farmers should not really be whether or not to have it, but how much and of what kind. The benefits of more intensive forms of supervision should be carefully compared to the additional costs.

- References: (1) "The Use of INCORA Supervised Credit in Colombia in 1969" by Dana Dalrymple, AID Spring Review of Small Farmer Credit, Volume V, 12 pp.
- (2) "Technology, Profit, and Agricultural Credit" by Ronald Tinnermeier, AID Spring Review of Small Farmer Credit, Volume XIX, 16 pp.

E. Economic Efficiency

- Questions:
- Has a vigorous effort been made to reduce administrative and supervisory costs, learning from those informal and formal banking systems which have successfully decentralized their operations, eliminated unessential red tape (such as tied loans), and exploited channels, services and information already available? What about default costs?
 - Does the credit program have an internal or an associated mechanism for encouraging and collecting rural savings?
 - Is there evidence to suggest that program funds are merely substituting for private credit - informal credit - especially for the purchase of seed, fertilizer, labor and other fairly divisible expenditures?
 - Has a vigorous effort been made to harness sources of private capital, particularly commercial bank funds? If private banks are not lending directly to farmers, are they at least financing the operations of other primary lending organizations, such as cooperatives?

Administrative and supervisory costs associated with small farmer lending tend to be high and in some countries default rates are also high among small farmers. Given the constraints on what they can charge, credit agencies cannot cover costs, let alone default, on their loans. There is no simple solution to this problem.

Nevertheless, if administrative costs were reduced, and interest

rates made more realistic, credit institutions could more readily afford to lend to small farmers. What is needed is a "low cost delivery system" for agricultural credit which would compare to the conventional credit distribution system as the recently publicized low cost delivery systems in health and education compare to the more conventional distribution systems for health and education services.

The Spring Review did not investigate the issue of economic efficiency, or cost-effectiveness, with the thoroughness that it demands and cannot offer a list of proven cost-cutting expedients. Grouping farmers (see III A below) can often be an efficient way of lowering costs and default, if the group accepts responsibility for the individual repayments. The honesty of the system is important. Decentralization of operations, especially of loan review and approvals, will also help. One technique of decentralization may be to encourage the formation of farmer associations in which "credit and finance committees" carry out a great deal of the administrative work - at no expense to the government. In general, administrative cost cutting characteristics of informal credit and other private credit systems can be imitated. (Note that although the price of credit, i.e., the

interest rate, is high in the informal market, administrative costs may be relatively low.) As mentioned above in Section II C, the key to reducing the costs of supervision and default lies in selective lending to farmers who face productive opportunities. If they do, they will be more likely to invest the funds advanced. The need for supervision will be lessened and the probability of repayment and the justifiability of higher interest charges will be greater.

Aside from measures to reduce costs in a given credit program, one should also keep in mind the broader spectrum of rural capital formation. A much wider variety of possible strategies to improve the flow of finance to small farmers must be considered. Both savings and informal market transactions should be recognized as alternative sources of investment funds; the more agricultural investment can be financed through these funds, the less the burden on public agricultural credit institutions. Similarly, means of harnessing private sector institutional funds for small farmers, as in the Philippines' Rural Banks program, should be explored

References: (1) "The Case for Voluntary Savings Mobilization: Why Rural Capital Markets Flounder" by Dale

Adams, AID Spring Review of Small Farmer Credit, Volume XIX, 16 pp.

- (2)q "Informal Lenders as Suppliers of Development Credits to Small Farmers in Developing Countries: Attractive or Deceptive Alternative" by Charles Nisbet, AID Spring Review of Small Farmer Credit, Volume XV, 12 pp.
- (3) "Agricultural Credit for Small Farmers in the Middle East" by Thomas Strickley, Raja Mouracade, and Yusuf Kashshu, AID Spring Review of Small Farmer Credit, Volume IX, 17 pp.

III. INSTITUTIONAL ISSUES

A. Alternative Delivery Systems

- Questions:
- Has a vigorous effort been made to group farmers for credit/information/marketing transactions?
 - What mechanisms are available to obtain feedback from the farmer on the type of delivery system which is most appropriate to him? How can farmers be included in the planning and decision-making process associated with their credit program?
 - What are the characteristics of the local informal market? How can the relative advantage of this informal system be exploited by the delivery system?
 - What steps can the government take to encourage more private institutional financing of agricultural production - particularly by smaller farmers?

Various institutional mechanisms for delivering credit to small farmers have been tried. The most common one appears to be government supported "group credit," i.e., public lending to small farmers grouped into cooperatives, credit unions, or more informal farmers' associations. Of course, in some programs loans are extended directly to the small farmer, but administrative costs of direct funding are very high. In other programs, public funds are channelled to farmers through private intermediaries - either through conventional commercial banks, special rural banks, or

individual agents. Private agencies appear to have both lower administrative costs and default rates. However, it is clear that in distributing credit through private channels, the government loses some control over both who gets the funds and to what use the money is put. Private lenders are more interested in repayment than in fostering development projects.

Another danger of course, is that private lenders will extend the credit to small farmers but at exploitative interest rates. Evidence suggests that the problem of monopoly in rural credit markets has been exaggerated, but, where it is a problem, the strategy should be to eliminate the excess profit, not the moneylender, or private agent. This is best done by developing alternative sources of funds - both public and private - not by imposing new usury laws or by outlawing moneylenders who provide farmers a real service. Specific steps which governments can take to urge commercial banks to increase agricultural credit financing include the relaxation of (a) the usury laws, thereby allowing commercial banks to engage in more risky lending operations at higher interest rates and (b) the restrictions on commercial bank financing of moneylenders, thereby encouraging competition among this group. Higher lending rates will also

permit banks to pay out realistic deposit interest rates, which, by increasing the supply of savings and hence loanable funds, may provide competition to the moneylenders.

Group credit is often preferred for four reasons: (1) it lowers the administrative costs of lending, at least from the standpoint of the banking institutions; (2) it lowers the default rate, and hence total costs of the program, where group responsibility is enforced; (3) it can be more easily combined with savings mobilization; and (4) the group can assist the credit agency in assessing the credit needs of individual farmers. It is also argued that through groups, small farmers can obtain sufficient political power to force local governments to be more responsive to their needs. The actual record of group credit, however - particularly cooperatives - has been mixed. Corrupt or incompetent management, political abuse, and default by group members may cause the group endeavor to fail. Success factors are perhaps more difficult to pinpoint, but one recent study (see Carroll below) points to the following:

- i. Homogeneity (both ethnically and by income class) of the group members;
- ii Group responsibility for loans;
- iii Well-intentioned and competent political and managerial

leadership (at both national and local levels);

- iv Provision of technical services (ideally medium and long term development services as well as short term technical advice).

Integrated marketing arrangements which permit deductions of farmer repayment obligations from gross revenues are also recommended, but evidence attesting to the extreme efficiency of traditional marketing channels in many countries brings into question any blanket endorsement.

The Spring Review country papers reveal that credit programs - irregardless of the specific delivery system - are generally excessively bureaucratic and heirarchical. Farmers are excluded from the decision making process and there is no account taken of their ideas. Not only are the credit agencies inflexible and plagued by red tape, but they are often unresponsive to farmers' needs. Special efforts are needed to shorten the hierarchical lines of authority and communication, to incorporate a mechnism that will feed back farmer ideas to decision makers. Credit agents should be recruited from the farming community and an incentive system developed to make the agents more concerned with the problems of the farmer than of the bureaucracy. Including farmers in the planning and decision process would reduce their

alienation from the credit agency and increase the credit agency's responsiveness to farmer needs.

No one distributive system tried to date can be cited as superior to all others. It should be possible, however, to experiment with several alternative systems in an attempt to find one that is compatible with local culture, reasonable in costs, and successful in identifying those small farmers with good investment opportunities and in establishing an effective institution/clientele relationship. Experience from the Review indicates that irrespective of the mechanism utilized, greater attention needs to be given to organizational development and improved management if successful credit programs are to result.

- References: (1) "Group Credit for Small Farmers" by Thomas Carroll; "Co-ops Can Help if Governments are Willing" by Edgar Owens and Charles Antholt; and "Cooperatives and Development Through Small Farmer Credit" by Jack Dublin, AID Spring Review of Small Farmer Credit, Volume XIX, 30 pp.
- (2) "Informal Lenders as Suppliers of Development Credits to Small Farmers in Developing Countries: Attractive or Deceptive Alternative" by Charles Nisbet; "Some Aspects of the Utilization of Existing Credit Sources by Institutions Applying Public Funds to Small Farmer Credit Programmes in Africa" by Richard Roberts; and "The Rotating Credit Association: A "Middle Rung" in Development" by Clifford Geertz, AID Spring Review of Small Farmer Credit, Volume XV.

- (3) "Regional Similarities and Differences in Small Farmer Credit" and "Notes on Developing Small Farmer Credit Institutions in Third World Countries" by Marvin Miracle, AID Spring Review of Small Farmer Credit, Volume XIX, 14 & 12 pp.
- (4) "Analysis of Organizational Aspects of Small Farmer Credit Programs" by Jerome French, AID Spring Review of Small Farmer Credit, Volume XIX, 13 pp.

B. The Package Approach to Credit

- Questions:
- Has agricultural credit been considered in the context of a "package" approach?
 - What should be the role of government, specifically the agricultural credit institution, in providing the "critical minimum" elements required for small farmer development?

As mentioned previously, the constraints on agricultural development are numerous. Sometimes the key constraint is a shortage of credit; other times it may be the absence of a more productive technology, incomplete or inadequate information about more productive technologies, misjudgement about the expected return, or risk aversion on the part of the farmers. Shortage of required inputs or marketing problems (price risks, inaccessibility of markets, etc.) also act as constraints. Often more than one constraint applies in a given geographic area; in such a situation credit alone can not be effective. The other missing inputs must also be supplied either by government or the private sector. In planning a credit program considerable attention should be given to whether credit alone will be sufficient or whether the government needs to see that the other constraints are addressed. In some cases this may involve direct government input supply or marketing programs.

Once the government decides to intervene, it must also decide whether the package of services should be provided by one or more governmental agencies. A multi-service approach by one institution often presents a way of reducing the per farmer costs of providing services at the local level. On the other hand, a multi-service approach results in organizational complexity, and a need for higher degrees of management competence. It is sometimes argued that, with a package approach, credit agencies tend to lose both their primary focus as financial institutions and the benefits of professional specialization, particularly at the local level. The scope of activity best suited to credit agencies will undoubtedly depend on circumstances such as the competence and training of available personnel and the additional services required to stimulate farmer development. If a multi-service approach is adopted, an attempt should be made to keep separate the costs and revenues from the various activities. Unless a relatively clear record of revenues and costs can be established, it will not be possible to judge the success of the various elements of the program, and losses incurred on one service might lead to the abandonment of the entire program.

Reference: "Role of Credit in the Economic Development of Small Farmer Agriculture" by Chester B. Baker, AID Spring Review of Small Farmer Credit, Volume XIX, 27 pp.

C. Graduation

Question: - If the program subsidizes participants, and if government is not prepared to eliminate the subsidy, can a graduation policy be instituted?

As long as the credit program contains a substantial subsidy, the demand will exceed the supply of available funds. Compared to those who would like institutional credit, few will receive it. On equity grounds it therefore seems appropriate to "graduate" (i.e., to transfer from a subsidized program to a non-subsidized program) successful farmers in order to extend the subsidy to more needy individuals. Institutions are of course somewhat reluctant to graduate farmers who pay their debts; furthermore, it is more costly for institutions to build a new credit relationship than to continue an existing one. Still it is important to see participation in a subsidized credit program as a transitional phase. A graduation program, therefore, should be structured so that the farmer himself has an incentive to graduate. As an example, one can envisage a subsidized program in which the interest rate on credit would be slightly higher than the rate in other programs. In this way, the subsidized public program could provide access to credit to the non-commercialized small farmer, but at the same time would provide him the incentive to transfer to other programs as soon as he is eligible.

(The assumption here, of course, is that the magnitude of the subsidy, which could be provided by means of extension or other services, would exceed the interest rate differential.) As farmers adopt new technologies with a consequent rise in income, they should be able to finance additional investment through personal savings or institutions other than those subsidized by the government.

Reference: "Subsidized Small Farmer Credit - The Graduation Problem" by Philip E. Church, AID Spring Review of Small Farmer Credit, Volume XIX, 17 pp.

D. Monitoring Credit Programs

Question: - Has the information gathering and evaluation process been institutionalized in the agricultural credit institution?

The Guidelines have summarized the many problems that have plagued agricultural credit programs in the past. Any mission considering support for an on-going credit program would wish to review how well the program has performed in these areas. Obviously where past performance has been deficient, negotiations should be carried on with the credit institution to determine policy and/or management changes which might rectify the situation. However, the procedure should not stop with the institution of new policies. The credit agency should develop programs of evaluation and applied research to provide decision-makers with continuing feedback. Detailed information should be gathered on several priority topics - especially the distribution of credit, default and delinquency, the costs of administration, and the impact of programs on output. The information gathered should be sufficiently detailed to find the correlation between any of the above and the size of borrower, the type of program, and the region of the country. Information on distribution, delinquency, and costs should be available to the credit agency from information already collected or easily collectable. For regular participants

in credit programs information on outputs is often gathered from the annual loan applications; if not, it could be added. However, for purposes of determining the impact of the credit program on output, data should also be collected on a control group of farmers who do not receive institutional credit. The additional costs of collecting this information and carrying out the analysis are justified by the importance of ascertaining the impact of the credit program as distinct from other events on participants' output. Cost can be minimized and the utility of results maximized if data collection and analysis is built into the management operations of the credit institution. The information collected does not have to be in the form of complete enumerations. Well-designed samples will be less costly (much less in a large program) and, if carefully executed, more reliable than complete enumeration.

Reference: "Institutions and Institutional Issues Associated with Small Farmer Credit in Developing Countries" by John R. Brake, AID Spring Review of Small Farmer Credit, Volume XIX, 13 pp.