No. 19

PN-ABJ-208

Experiences with Supervised Agricultural Credit

by

Ronald Tinnermeier*

Introduction

Since the early 1950's the Agency for International Development (AID), the Inter-American Development Bank (IDB), and the World Bank group have placed considerable emphasis on agricultural credit in their loan and grant programs. AID, for example, has destined over one-half of its total direct assistance to agriculture in Latin America for such credit purposes[1].

The assistance for agricultural credit has not been uniformily distributed worldwide. During the period 1960-1968, over 70 percent of the AID and World Bank loans for agricultural credit activities were received by the countries of Latin America. Most of the AID loans were combined with technical assistance, most often under supervised agricultural credit. A number of IDB loans have also supported this type of activity. In the case of Peru, almost all the agricultural credit extended by AID and IDB has been of this type.

This paper is for the purpose of evaluating the experiences of selected countries in carrying out supervised agricultural credit. The case of Peru will serve as the primary reference although the observations apply to many other countries with supervised agricultural credit programs. Latin America has experimented extensively with supervised agricultural credit and this paper will reflect a bias toward those experiences.

Supervised Agricultural Credit

Supervised agricultural credit is the term employed for production credit which is coordinated or combined with the provision of technical and financial advice. It implies that the borrower is not judged upon his own ability to use the credit wisely but rather according to the potential effects of innovations or changes in his farm operations from using supervised credit. In consequence, the success of a supervised credit program is primarily dependent upon the soundness and reliability of the technical supervision provided by the program itself.

Credit programs which fall within this general definition can be found in most countries of Latin America and in other parts of the world. Some are called "supervised", others "directed", and still others "oriented" credit programs. In essence, they are all supervised agricultural credit programs, that is, they depend to some extent on the supervision and advice of the lending agency. The use of the different terms, no doubt, is an attempt to distinguish the programs according to the amount of technical advice provided.

The traditional supervised agricultural credit approach is normally one where selected families receive short and long-term production loans, combined with individual farm and home plans and where close supervision of their farm operation during the loan period takes place. However, due to financial and personnel restrictions, most programs are able to provide only a portion of the supervision that is recommended or required.

When one speaks of supervised credit it is almost universally associated with small and medium size farmers. It is usually assumed that the larger farmers are able to apply capital wisely and are, therefore, able to obtain regular production credit loans.

Experiences with Credit

The first supervised agricultural credit program is said to have begun in Paraguay in 1943. Brazil and Venezuela began similar programs in 1948. Most of the remaining countries of Latin-America began programs later, largely with bilateral or international financial assistance[2]. Generally, cooperative credit has been emphasized over supervised agricultural credit in the rest of the world.

The social-economic characteristics of the farmers subject to credit vary greatly from one country to another. But in general, the majority of the small and medium size farmers lack sufficient capital, have low productivity levels, use limited amounts of non-farm inputs, have low incomes, all of which, combined with little or no education, little technical knowledge, and small acreages, provide a real challenge for any supervised credit program.

Although the supervised credit programs operate under quite diverse conditions, there are a number of conclusions or common experiences which have resulted from their credit operations.

Need for well-defined objectives.- One of the first requirements of any program, supervised credit, or otherwise, is the definition of goals. What are we trying to accomplish? How will we know if we are making satisfactory progress? A commonly recognized goal of supervised

credit is to raise the level of living of the families receiving credit. Unfortunately such a goal or objective is long-term in nature and is vague and difficult to measure. It is necessary that a more quantitative measure be used.

A more specific objective of supervised credit is to create viable, commercially-oriented farms. This main objective can be measured by looking at the sub-objectives of increased productivity, increased use of non-farm inputs, especially improved seeds and fertilizers, increased family net income, and increased participation in the market economy.

Other objectives such as import substitution of agricultural products and social welfare should not over-shadow the primary objective of creating farmers who will be good credit risks in the future. Substituting locally-produced crops for imported crops, for example, depends as much or more on the related economic incentives as on the availability of credit. Product prices, import-export tax incentives, technical assistance, and experimental work, decide or influence which crops will be financed.

Programs which provide cash credit for family labor, other than for demonstrated need, run the risk of high delinquency, of becoming identified as a social welfare program and of loaning to the same farmers year after year. Such a program will not satisfy the primary objective of preparing viable, credit-worthy farmers.

Some farmers cannot benefit from credit.- All programs, sooner or later, recognize that there are farmers at the low end of the economic

and social scale that cannot be helped with supervised credit. These are farmers with very small parcels, too small to provide even a minimal subsistence living, who practice traditional production techniques, and who are so deficient in all respects that they are unable to take advantage of the credit and technical assistance extended by a credit program. Before receiving credit they require complementary services such as education, employment opportunities, public health, and more productive resources (land through land reform or colonization). Providing credit (capital which is expected to be paid back) only deteriorates their already precarious situation.

Because of the high cost of supervised credit and the intensive type of supervision that must accompany it, borrower selection is imperative. No supervised credit program has been able to reach all potential borrowers due to limited finances and personnel. The more successful programs are those that select farmers who demonstrate the potential for taking advantage of the technical advice combined with credit. Often "early adopters" are relied upon to serve as good examples for the others in the area.

Evaluation requires reliable data.- The relatively high-cost supervised credit programs require a continual evaluation to guarantee that satisfactory progress is being made toward the established goals or to suggest changes which must be made to obtain satisfactory progress. If the objectives are well-defined then the evaluation can also be more objective and useful.

As a general rule, information is not readily available for evaluation purposes. In the case of Peru, for example, data showing the

number of individual borrowers is not available nor is it possible to obtain current delinquency figures. Other programs, such as that of the Dominican Republic, produce a wealth of data but little attempt has been made to analyze these data for evaluative purposes.

Relevant questions for any supervised agricultural credit program are: what are the characteristics of the borrowers? Their number? How many new farmers enter each year and how many "graduate"? What evidence is there that the credit has had a positive impact? Has productivity increased? What crops or activities should be emphasized? Are there large differences in the marginal productivity of the capital? Are more non-farm inputs being used? Have family net incomes increased and by how much? What is the delinquency rate? What are the causes of delinquency and what are the possible solutions? Is there evidence of on-farm investment and capital formation? Has the debt structure of the borrower improved?

The role of a good research or evaluation unit can be highly significant for the progress of a supervised credit program. Mistakes will be made but they can serve as valuable leesons. A program must be flexible enough to profit from these lessons by making the required changes.

Importance of technical assistance and supervision.- Almost without exception, all supervised credit programs have experienced problems providing technical advice, the most crucial and vulnerable part of supervised credit. Practically all borrowers receive technical assistance for the first time through the program, and given their limited resources and capabilities, they require very extensive individual attention. This is where many supervised credit programs begin to break down. A credit

supervisor must not only know credit but he must also be a livestock and crop specialist, a farm management advisor, an expert on financial matters, and be informed on marketing and price considerations. It is obvious why this has been a common problem for supervised credit programs.

It is almost universally recognized that the interest charges cannot be expected to cover the technical assistance part of supervised credit. This expense must be considered as a public service and be included in the national or state budget as such.

Because technical assistance is so crucial for supervised credit, a program must necessarily be accompanied with adequate budget support: (1) to provide in-service training for the credit personnel so that they acquire the necessary technical skills, (2) to give the necessary technical backstopping by extension and commodity specialists, (3) to provide transportation facilities and other associated costs to enable the credit technicians to make on-farm visits to adequately supervise the loans, and (4) to finance on-going research and evaluation studies to suggest policy and organizational changes for program improvement.

In addition, the more successful programs have begun on a very small scale, often as pilot projects. The initial experimentation period allows time for training field personnel, for setting up uniform application and processing procedures, and for adjusting to the realities of providing supervised credit under the unique environment of the area affected. As funds and the capacity of the institution increase, the program is gradually extended to cover a larger area. Great care must be taken not to over-extend the program and thereby surpass the supervisory capacity of the lending agency resulting in program failure, or at best, in mediocracy.

Subsidized interest rate issue.- Almost without exception, supervised credit programs have consistently used concessional or "subsidized" rates of interest. Due to inflation, such rates have resulted in negative real rates of interest. Generally, supervised credit interest rates have been from as low as 4 percent to a high of 12 percent per year while rates of inflation have varied from 10 percent to over 100 percent or more.

There are advantages and disadvantages of using the concessional rates[3]. When the larger farmers are receiving production credit through state banks at concessional rates, similar rates for supervised credit programs give the smaller farmers the same benefits.

A second argument presented by those favoring subsidized interest rates has been that this encourages the farmers to adopt new productive inputs requiring credit.

On the other hand, concessional rates of interest bring on a number of disadvantages. The most important being the continual erosion of the real value of the credit funds. A negative real interest rate of 15 percent will cause the real value of a fund to decrease to one-half its original value in only four years.

Concessional rates also probably account for part of the continually increasing demand for credit resulting in periodic credit scarcity, a phenomenon experienced by all credit programs. Such scarcity forces the continual search for external financing. Even more serious, subsidized interest rates affect the allocation of resources within agriculture and the economy. High negative real rates tend to place more emphasis on asset accumulation to the detriment of increased

production and efficiency. It may also over-emphasize the economics of mechanization thereby replacing labor which is already under or unemployed.

Finally, concessional rates of interest directly affect agricultural cooperatives and credit unions. These organizations find it very difficult to cover administrative and supervision costs for making sub-loans to members when the rates of interest for individual loans are subsidized.

Supervised credit through cooperatives.- Supervised credit technicians are often interested in forming cooperatives to extend their influence. They rationalize that by providing credit through cooperatives they will be able to reach more farmers with the same resources. Their experiences have been quite mixed.

One of the first problems facing a cooperative extending sub-loans is the concessional interest rate which exists in each country, as discussed previously. Unless the cooperative is able to obtain an even more favorable concessional rate, it finds itself in a difficult position. Either it must cover the credit administrative costs from other income sources or it must charge a higher rate of interest to the farmers. Most cooperatives have opted for the second alternative leaving them open for criticism because they charge more than the State agricultural bank.

A second problem of cooperatives is the lack of adequate administrative and internal control. The granting of sub-loans implies the cooperative is capable of handling the accounting, interest calculations, and collection responsibilities related to supervised credit. Unfortunately, a cooperative with these capabilities is the exception rather than the rule. Experience has shown that cooperatives can often complement the regular supervised credit programs by obtaining economies in the

purchase of inputs and in the marketing of farm products. Once a cooperative demonstrates its ability to work in these areas then it can consider accepting the more difficult responsibility of providing supervised credit to its members. If a supervised credit program is already in difficulty, due to lack of adequate technical assistance or extension capabilities, or for other reasons, transferring credit through cooperatives will only compound the problems.

One advantage of channeling supervised credit through cooperatives is to enable local capital accumulation to take place. Although little is known about how responsive rural people might be to increases in the rates of interest paid on savings and from other types of stimulus, there is some evidence to suggest that rural voluntary savings could be significant in reducing the need for external financing. Historically, agricultural cooperatives have not tried to mobilize local savings.

Loan delinquency and capital erosion. - The effect of concessional rates of interest and inflation on the real value of a credit fund over time has already been discussed. Loan delinquency also affects the value of a credit fund but more directly. A 15 percent default rate, as for a similar negative interest rate, will reduce a fund to one-half its original value within four years. The two factors combined can significantly erode a supervised credit fund in a very short time. To maintain itself under these conditions additional outside resources would be required.

Fortunately, many of the supervised credit programs of Latin American have been able to maintain delinquency at reasonable levels, with some exceptions. The programs of Mexico, Colombia, Brazil, and the

Dominican Republic, to my knowledge, have held delinquency to 10 percent or less. No doubt other countries could demonstrate similar results. Peru, on the other hand, has had some serious problems of delinquency.

Final Comments

In this paper I have tried to summarize common experiences of selected countries in extending supervised agricultural credit. The main points which I have attempted to make are the following: (1) A considerable portion of internationally financed agricultural credit has been located in Latin American and has been channeled into programs of supervised agricultural credit. The main push in supervised credit took place during the 1960's. (2) For best results, the objectives of the supervised credit programs must be specific, obtainable, and measurable. Poorly defined programs bring about poor credit and consequently mediocre results. Supervised credit is for the purpose of creating viable farm units by improving the managerial ability and technical knowledge of the borrower and increasing input use so as to lift productivity, market participation, and net family incomes. (3) Any dynamic program must be flexible and subject to change as time dictates and as demonstrated by evaluation and research studies. Experience provides valuable lessons which must be incorporated into the continually changing program. Reliable and periodic statistical information is necessary for such evaluation. (4) Technical assistance is the most important part of supervised credit and is therefore the prime determinate of a programs' success or failure. All programs have experienced problems with obtaining or holding well-trained personnel. Continual in-service training is required to provide the required technical skills for the credit supervisors. The budgetary support for these activities must come from outside the program. (5) Con-

cessional interest rates, although used by most Latin American countries, have little in their favor. The disadvantages outweigh the limited advantages. (6) Extend supervised credit through cooperatives has not met with much success because of lack of administrative and other controls. Cooperatives can play an important role in purchasing inputs, marketing farm products, mobilizing local savings, and, after demonstrating capabilities in these areas, they can attempt extending production credit. (7) Loan delinquency in the supervised credit programs has been equal to or in some cases less than that experienced by the State agricultural banks. Nevertheless, due to its high cost, supervised credit must show positive farmer benefits to be justified.

These, then, are some of the common experiences of supervised credit. Regardless of how well a supervised credit program is operated, its ultimate success depends, above all, on a strong governmental attitude towards agriculture in general and supervised credit in particular. The credit programs must be accompanied with all the other necessary conditions of readily available inputs and markets, a price structure which provides some stability, price levels that permit reasonable returns to the producers, transportation and storage facilities for farm commodities, and applied experimental research to provide the technical knowledge required for a dynamic, modernizing agricultural sector.

*Associate Professor, Colorado State University. Previously Visiting Assistant Professor, North Carolina State University Agricultural Mission to Peru.

[1]Dale W. Adams. "Agricultural Credit in Latin America: External Funding Policy", Occasional Paper No. 9, Department of Agricultural Economics and Rural Sociology, The Ohio State University, April, 1970. pp. 1-4.

[2]Publications describing some of the programs include: Dario B. Brossard, ed. Una Nueva Modalidad de Credito Agrícola, (FAO No. 77, Roma 1965) for Mexico, Brazil, and India; Charles T. Nisbet, "Supervised Credit Programs for Small Farmers in Chile", Inter-American Economic Affairs, Autumn, 1967; Ronald Tinnermeier, et al. "An Evaluation of Selected Supervised Agricultural Credit Programs in Peru", Report submitted by North Carolina State Mission to Peru to AID, June 1968 (also in Spanish); D. W. Adams, El Crédito Supervisado en la Reforma Agraria Colombiana: Un Estudio Evaluativo, (Bogotá, Colombia: Centro Interamericano de Reforma Agraria, 1966); José Paulo Ribeiro and C. R. Wharton, Jr., "The ACAR Program in Minas Gerais, Brazil" in Subsistence Agriculture and Economic Development, edited by Clifton R. Wharton, Jr. (Chicago: Aldine, 1969); and Elizabeth Bauer, ed. Proceedings of the International Conference on Agricultural and Cooperative Credit, August 4 to October 2, 1952. (Berkeley, California: University of California, 1952).

[3]For a review of these justifications see: Adams Paper November 9, 1970. pp. 22-26.