

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D. C. 20523
BIBLIOGRAPHIC INPUT SHEET

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Batch 28

1. SUBJECT CLASSIFICATION	A. PRIMARY Agriculture	AE10-0000-0000
	B. SECONDARY Agricultural economics	

2. TITLE AND SUBTITLE
Some environmental considerations influencing agricultural credit in developing countries

3. AUTHOR(S)
Curry, C.D.; Early, J.O.; Sorensen, D.M.; Stansbury, D.L.

4. DOCUMENT DATE 1967	5. NUMBER OF PAGES 15p.	6. ARC NUMBER ARC 332.71.C976
--------------------------	----------------------------	----------------------------------

7. REFERENCE ORGANIZATION NAME AND ADDRESS
Ohio State

8. SUPPLEMENTARY NOTES (*Sponsoring Organization, Publishers, Availability*)
(In Review and appraisal of recommendations for agr. credit systems and institutions in developing countries, v.2)
(In AFC research pub.no.106)

9. ABSTRACT

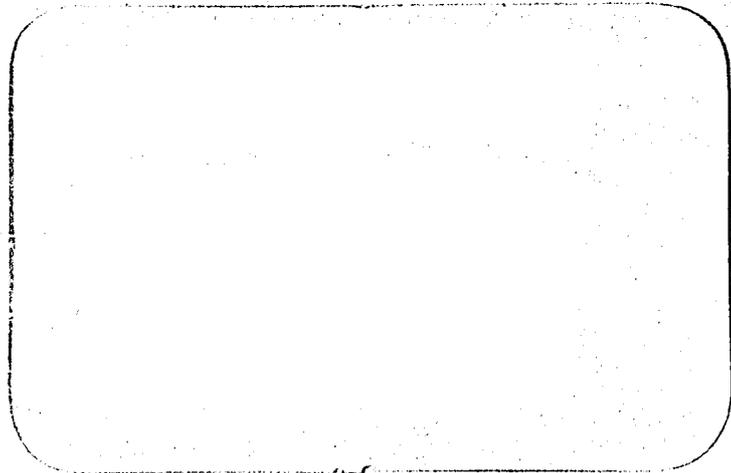
10. CONTROL NUMBER PN-RAB-518	11. PRICE OF DOCUMENT
12. DESCRIPTORS Credit Developing countries Environments	13. PROJECT NUMBER
	14. CONTRACT NUMBER CSD-463 Res.
	15. TYPE OF DOCUMENT

CSD 463 Res

332.71.C976

518

**an
agricultural
finance
paper**



AGRICULTURAL FINANCE CENTER

**Department of
Agricultural Economics and Rural Sociology**

**THE OHIO STATE UNIVERSITY
COLUMBUS, OHIO 43210**



AFC Research Publication 106--Volume II

SOME ENVIRONMENTAL
CONSIDERATIONS INFLUENCING
AGRICULTURAL CREDIT IN
DEVELOPING COUNTRIES

May, 1967

Charles D. Curry

John O. Early

Donald M. Sorensen

Dale L. Stansbury

Volume II of a Review and Appraisal of Recommendations
For
Agricultural Credit Systems and Institutions in Developing Countries

Agricultural Finance Center
Department of Agricultural Economics and Rural Sociology
The Ohio State University

Under Research Contract AID/csd-463
between
The United States Agency for International Development
and
The Research Foundation, The Ohio State University
Columbus, Ohio

FOREWORD

The Agricultural Finance Center of The Ohio State University has assembled quantities of materials dealing with agricultural credit in developing countries. (See AFC Research Publication 111, "Bibliography of Agricultural Credit," Agricultural Finance Center, The Ohio State University, Columbus, Ohio). These include a variety of reports, recommendations and miscellaneous observations on the organization and operation of agricultural credit institutions.

This report is the second of a series in which the various comments and recommendations for agricultural credit in developing countries are summarized, digested and presented. The first (AFC Research Publication 106, Volume I) dealt with the function and scope of agricultural credit. The third, to follow, is concerned with the motives for establishing agricultural credit institutions.

Since many of the source materials used in compiling the report are classified or sensitive, references to sources are deliberately omitted, as are references to individuals, countries and institutions.

While these reports do not pretend to deal in depth with the subject of agricultural credit, it is hoped they will provoke debate, decision and action based on a realistic consideration of the factors involved within a country when designing agricultural credit institutions and systems.

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**SOME ENVIRONMENTAL CONSIDERATIONS
INFLUENCING
AGRICULTURAL CREDIT IN DEVELOPING COUNTRIES**

INTRODUCTION

The supply of and demand for agricultural credit is, to a considerable degree, a result of the environmental setting within which the credit institution and the agricultural firm operate. The environmental setting is composed of groupings which shall be considered separately. These groupings, their activities and their relationships individually and collectively influence national programs of agricultural credit. The environmental factors are inter-related, and change in one is both the result and cause of change in others. Some are fixed and set limits beyond which development programs are ineffective. Others, which can be modified, pose the critical problem to planners of determining--in amount, sequence and timing--how severely limited developmental resources shall be allocated among the many demands of the environment.

For purposes of this report, environmental considerations will be grouped into natural, social, political and economic areas. When the environmental considerations are developed to the extent of favoring or inducing resource investment, effective programs of agricultural credit may be achieved. Conversely, deficiencies and maladjustments of the environmental considerations inhibit economic development and restrict investment in agriculture, thus making effective and continuing programs of agricultural credit difficult to achieve. However, some types of agricultural credit systems have been operative with varied degrees of effectiveness under both favorable and less favorable conditions. This poses such questions as: (1) what are the basic principles governing effective programs of agricultural credit; (2) what dependable guidelines can be formulated for establishing and operating enduring and effective agricultural credit institutions; and (3) under what conditions or environmental constraints must these guidelines be modified?

The following environmental groupings are not all inclusive but are intended to indicate some of the inter-relationships and importance of non-economic factors. Development of these components of the environment is necessary to enable agricultural producers to employ agricultural credit productively and benefit from its use.

NATURAL RESOURCES

The natural resources, land, water and climate, establish maximum and minimum perimeters for the production of agricultural commodities. These resources must be considered in the aggregate since the limitations of one offset the effective use of the others.

Technology may make it possible to overcome the inadequacies to some extent, as with irrigation, drainage and fertilizers. The limitations imposed by natural resources to achieve economic agricultural production must be appraised and feasible plans developed for modifying these conditions concurrently with or prior to credit extension.

Land

Ordinarily, the more accessible and better lands already are settled and have varying degrees of productivity. With the evolution of land tenure programs, new patterns of land-man relationships are being established. From the viewpoint of resource allocation, the important question becomes: what is the economic potential and optimum use of land? Recognizing the need for an economic base to support social development programs, it is apparent that some form of financial investment must be available to support changes in land-man relationships.

The natural fertility and topography of land resources not only limit repayment capacity, but may be major factors in the need for credit. Funds for the purchase of fertilizers, for the clearing and leveling of land and for development of facilities which facilitate the use of the land may be a function of credit.

Water

Economic agricultural production, both plant and animal, is directly correlated with the availability of adequate water resources; consequently credit repayment from crop or livestock production is directly correlated with water resources. Water resources can overcome many climatic deficiencies. The productivity of wet land can often be enhanced by drainage, and under drought conditions irrigated farming may have a much greater capacity for loan repayment than does non-irrigated farming. In considering allocation of credit funds to irrigated farming enterprises, the lender must be concerned not only with the availability of water, but amount of water, the timing of the water, and the quality. However, irrigated farming has technical problems beyond the minimum levels of productivity and beyond the capabilities of many borrowers. Thus, while repayment capacities of irrigated farming are potentially greater under certain conditions than non-irrigated, the requirements, both technical and financial are also significantly greater. Likewise, the profitability of livestock operations is materially affected by a supply of water.

Climate

Climatic considerations are effective regulators of crop production. Agricultural credit must be concerned with temperature, rainfall, sunlight and weather patterns. These considerations, largely beyond the control or influence of man, nevertheless, restrict agricultural activities to the extent that credit investments are materially affected. While it is not the intent of this report to seek a formula whereby credit is correlated with climate, it is essential that credit institutions be very much concerned with these climatic considerations, not only on a current basis but from a historical point of view. In extending credit the lender must be aware of climatic factors, their probability and their intensity and adjust credit terms to the hazards indicated.

SOCIAL

The horizons, cultural traditions, attitudes, values, health, education and technical level of potential clientel of an agricultural credit system influence the character and amount of investments that investors and creditors are induced to make for production and marketing activities. Likewise, these social influences have a direct bearing on the potential for constructive use of credit and on the credit worthiness of applicants.

Horizons

The horizons of a potential user of credit strongly influence the purpose for which credit is sought. Horizons are influenced by the experience, visions, hopes and goals of the people.

Where the overall physical, social, political and economic environment is favorable, accompanied by individual ingenuity and opportunity for socio-economic betterment from investment of resources, individuals normally will pursue activities to achieve these ends.

Where the visions and hopes of a people are limited by cultural patterns and beliefs, social and economic aspirations often adjust to the course of least resistance at the expense of work patterns, ethical standards, health and the credit worthiness of the individual. Conditions in a large portion of the world reflect the results of varying degrees of dissipated natural resources, low investment in productive chattels, inefficient use of labor, ineffective management techniques and low loan repayment capacity.

Changes which require innovation, the exercise of judgment, decision and decisive action are inhibited by inadequate vision. This results in perpetuating the traditional, the only system known. An injection of new concepts and capabilities is often needed to fully employ available resources. The opportunity for diversifying agricultural activities, knowledge of the socio-economic potential, and an understanding of new production and marketing techniques are not well developed or pursued in many developing countries. Experienced and well trained leaders are as scarce as monetary resources for modifying traditional customs and initiating new concepts into systems of agricultural credit even though the letter of the law itself may not restrict the establishment and implementation of innovations.

Cultural Traditions

The cultural traditions of a people are largely based on historically derived concepts which are generally accepted by a society as safe guidelines for a particular socio-economic activity. The horizons and goals of an individual play a large part in what the individual accepts as his guidelines, that is: What has the individual experienced? What has he been taught? Were teachings based on survival, power, and superstition or on a wide horizon of experience of successful utilization of resources to improve his socio-economic well being? It is difficult for an individual to believe in the validity and wisdom of practices he has never observed, experienced or understood. He must guide his actions by the best authority available even though the concepts stem from folklore, superstition and traditional practices for determining safe and normal courses of action. Further, when traditional cultural customs and moors are ignored, painful repercussions frequently result in social and economic ostracism, making it next to impossible for innovators in these societies to employ and repay credit for culturally unorthodox uses.

Attitudes

The attitudes of individuals are influenced deeply by their horizons and their cultural traditions. They affect the attitudes and beliefs of people regarding: valid agricultural practices; their responsibilities to institutions, including those providing credit; their work habits; and their willingness to cooperate with their neighbors in mutually beneficial activities. In fact, the social group may dictate effectively the total socio-economic activity of the individual and thus limit his opportunity to depart from traditional patterns of economic activity.

Values

Values associated with pride, individual dignity, ethics, political and economic pressures are derived largely from the socio-economic environment of individuals. These values have a significant effect on the ability of credit applicants to profitably employ loans for constructive agricultural purposes and to repay these loans from agricultural activities. They affect the ability of lenders to extend and obtain repayment of loans.

Before credit can be extended, wealth must have been accumulated by someone. It represents someone's savings: either voluntary and planned, or forced. Credit implies belief, confidence, trust and faith that credit extended will be repaid. Where pride and ethical standards decree, individuals will honor their promises and obligations, and debts are repaid if at all possible. The use of loan funds for purposes agreed upon at the time credit is extended and its repayment according to contract are heavily influenced by those things in which people pride themselves, the value placed on individual dignity, the respect borrowers have for the property of others, their ethical standards, and their economic capabilities.

Health

It is difficult for a man with debilitating illnesses or a man with family health problems to be fully effective in his economic pursuits. Health is a consideration when determining the ability of an applicant to utilize credit effectively. The correction of a health problem may enable individuals to take their place in a productive society. Thus, health rehabilitation may be a justifiable use of credit.

Education and Technical Level

Where the level of education and technical development is limited, credit institutions will need to assure that farmers have access to technical counsel and guidance in their activities to enable them to make effective use of agricultural credit.

Farmers need understanding of productive methods, efficient production and marketing procedures and financing to have an incentive to produce agricultural commodities to meet an effective demand. It is essential that they have sufficient knowledge and understanding to enable them to utilize and benefit from technical and economic information and guidance.

The level of technical assistance and counsel must be commensurate with the farmer's ability to comprehend and implement new techniques. As agricultural producers change from subsistence to commercial agriculture, education and technical ability become increasingly important for making and using additional investment productively.

Too frequently, education in agriculture has not been valued highly either from an economic or social point of view. Superior schools for higher agricultural education are limited in number. Often they have not been well supported or attended. A considerable number of those enrolled in schools of higher agricultural education have little or no farm experience. Further, few young people with farm experience can qualify for advanced education. All too often methods and procedures taught are not adapted to the needs of agricultural production, marketing and supply. Little has been taught, in many developing countries, regarding the organization and operation of the agricultural firm on an economic basis. In many developing countries knowledge is a possession to be treasured as a status symbol rather than to be shared and used for socio-economic development.

Without exception, people in the field of agricultural credit have reported an acute shortage of adequately trained and able agricultural credit technicians. Only recently have the pay, working conditions and job security of the agricultural credit technician received consideration. In many countries technicians able to counsel and guide farmers regarding the planning, organizing, financing and operation of productive, efficient and profitable agricultural firms are in short supply or non-existent.

Agricultural research has been carried on for many years in some developing countries; yet it has seldom received regular and adequate financial or technical support on a dependable, organized and coordinated basis. This is true in all phases of the agricultural economy. It includes in addition to research in agronomy and livestock production; marketing, farm management, agricultural engineering, credit, and agricultural economics. Further, the results of research have not always been made available to the general public. Reliable agricultural research and information are essential to farmers and agricultural credit institutions when making investments in an agricultural firm.

The relative level of technical agricultural development is somewhat indicative of the potential of the agricultural firm to utilize credit productively and of the amount of credit which may be required. There is little economic base for the profitable use of credit in a strictly subsistence economy. However, as economic development creates a commercial demand for agricultural commodities, greater investment is indicated for producing and marketing the required increased production. Likewise, a change from hand production to a mechanized agriculture requires additional investment for equipment; much of which must be financed by credit.

POLITICAL

As noted heretofore the effective regulatory measures of a socio-economic system within which credit institutions must function include natural resources and social behavior patterns. Political considerations also shape and influence the system through the development and implementation of policies, legislation, administration and controls. Political considerations are a powerful force in the evolution of socio-economic systems. For purposes of this report, political considerations will be concerned with the development and operation of credit systems. It is recognized that credit to agriculture does not exist in a vacuum, but is only a part of the total political environment. Thus, as has been noted, effective credit is dependent on a multitude of forces including the total legislative, administrative and judicial framework of a country.

Policy

In developing countries policy determinations usually recognize agriculture as a factor in economic development. However, within the broad context of the agrarian sector a significant divergence of opinion and thus, policy exists in relation to the establishment of goals, allocation of resources and priorities. At a relatively early stage of most development schemes, when the need for credit is recognized, there usually exists some enabling legislation for the establishment of agricultural credit systems. This enabling legislation may be sufficiently comprehensive to permit the establishment of a national program. Such acts should give public recognition to the role credit is expected to play in agriculture, set forth the purpose of the law, guide those involved in carrying out its objectives and include provisions to prevent its misuse.

In the larger countries the need for a more effective relationship between federal, regional or state credit operations is apparent. Without coordination, a proliferation of semi-autonomous entities occurs resulting in duplicating, competing and often conflicting governmental and quasi-governmental credit activities with a resultant dissipation of resources and a general lack of effectiveness. Thus while the need for credit has been generally recognized the organizational structure has not been recognized so clearly. Government policy toward the development of credit systems logically must be concerned with development of complete systems of credit which may not only include a recognition of the problem but the mechanism through which it may be achieved and lastly the financial means through which the objectives may be realized.

The financing of an agricultural credit system is necessarily influenced by government policy inasmuch as it relates to the allocation of financial resources, usually of a substantial magnitude. Funding an agricultural credit system involves not only the amounts of funds available but their timing and their continuity. It is unlikely

that the total constructive credit requirements of agriculture can be met regardless of sources, except over a very long period of time. Thus, a problem of allocation of credit resources is apparent from the outset. The development of any credit system must be very much concerned with the preservation of the value of these funds. If a revolving loan fund is to be established and kept intact, political expediencies must not displace or supplant sound policy considerations. Thus the policy considerations of a credit system must be concerned with not only establishing the system and its funding but also avoiding the dissipation of these funds. Effective policies to this end must be achieved and evidenced through realistic legislation.

Legislation

Legislative acts within the framework of government policy establish the perimeters and procedure of the credit system. Included in the system are all sources of credit, both private and government. Ideally these various sources of credit provide effective checks and balances on each other. However, this is not necessarily the case; in fact there tends to be little relationship between these separate sources.

Legislation pertinent to a credit system is needed and should be practical in application. This need not be of a highly sophisticated type but rather realistic to the effective restrictions of the socio-economic system.

The basic concern in the enabling legislation for a credit system is the provision for an effective, stable and continuing organization; one which is not subject to the chancing whims of political fortune, opportunists, or bizarre schemes. If a credit system is frequently subjected to radical redirection or reorientation, there is little likelihood of its effectiveness or success. An orderly and consistent approach must be the accepted mode of existence and operation. To this end it is fairly common for a credit system to be given a semi-autonomous status in an attempt to remove its operations from the political mainstream. Admittedly, this is not always possible, but to the extent that it can be achieved, the possibility of establishing and maintaining a successful credit system is materially enhanced.

In situations where a credit system is semi-autonomous, there is a tendency for the institution to become an end unto itself, thus posing a serious problem of correlating the activities of the credit institution with the total agricultural sector. It is essential that while a credit system must not be subject to political vagaries, it must be an intimate part and parcel of the total agricultural sector. This is not easily accomplished, nor is it accomplished through legislation alone. However, enabling legislation which properly provides for the integrity and continuity of the credit system is a basic prerequisite to its attainment.

Funding a credit system is an integral and vital legislative consideration. The power to attract and to borrow funds, and equally important, the power to collect funds must be present. Funding mechanisms usually present fewer problems insofar as authorities and responsibilities are concerned. However, much less concern is in evidence regarding responsibilities and authorities for the collection of loans. Policies regarding the latter consideration are often outside the jurisdiction of the credit system and thus enforcement is not usually a prime responsibility of the system. As a result, a general lack of concern for collection procedures has been noted. Effective credit systems must have effective collection systems. Legislative acts must establish the authority for collection of loans according to contract terms; provide recourse and remedies in case of willful non-payment; and establish clear and positive procedures for the preservation and integrity of funds entering the credit system.

Implementation of legislation is a responsibility of the administration of the credit system. Administration's best efforts should not, indeed must not, be concerned with interpretation; thus the need for clear and effective enabling legislation combined with effective and impartial judicial support is clearly imperative.

Administration

The administration of a credit system is concerned with an effective and equitable disbursement of funds according to agreement and with collecting those funds as provided by and in accordance with institutional policy, legislation and the loan contract. As such, a credit system must be out of the mainstream of political influence. So must its administration be removed from the political and economic pressure groups.

Impartial and effective administration of a credit system is a responsibility of its management. Breakdown in the administration of its program of credits and collections is readily observed in a variety of ways and is soon reflected in lack of confidence in administration by the borrowers. When borrowers lose confidence, for whatever reason, their repayments are restricted or foregone and shortly the credit system is faced with past due loans of dubious value.

It is the role of the administration of a credit system to implement policy, as established in the legislative process, fairly, aggressively, and effectively. This requires that political considerations and influences be kept outside the administrative process, and that supporting legal counsel and technical guidance be available to the system. To do less is to encourage the ultimate deterioration of the system.

Controls

Controls are an essential element in a credit system. No matter how well a program of credit is implemented and supported, there are essential restraints which must be a part of the process such as liens, legal action, inspection, audit, examination and investigation. These controls are an integral part of the credit process. If they are to have meaning, they must be understood, enforceable, and enforced. Defunct and failing credit systems are replete with defaulted loans due to lack of or improperly enforced controls.

The application and enforcement of the various control measures must be impartial and timely. Credit utilization is a matter of public knowledge, so is its repayment. Thus, when some borrowers do not repay their loans, there is a strong propensity on the part of other borrowers not to honor their commitments. There is a high correlation of collections to the application of controls. It is an erroneous concept to assume that credit "on the books" represents current assets. Failure to collect a credit when due all too often results in no collection at all. This is especially noted in production loans for seasonal recurring costs which account for the bulk of most agricultural credits.

Whenever credit commitments are deferred, diluted or eliminated in the interests of political or other expediencies, there is no chance whatever of a viable credit system being established. These practices are quickly observed by the clients of the system and are reflected directly in their rates of repayments. Thus it must be made clear, in the enabling legislation, in policy determination, in the administration, and in lender-borrower relationships that there exists a system of control, that borrowers will be held accountable for their loan commitments and that controls will be enforced.

ECONOMIC

Feasible and effective programs for providing credit to expand agricultural production and increase commodity marketing efficiency must be fitted to the current economic development in a country. The total economic development of any given country is dependent upon current aggregate socio-economic conditions for direction and starting point. The development of any one component is closely linked with the development of each of the others. The determining relationships must be considered in perspective when planning, organizing, staffing, operating and controlling a credit system for financing individual agricultural firms.

The demand for credit to agriculture comes into focus with increased resource requirements for producing and marketing agricultural commodities as predicated on an effective demand at the consumer level. The demand for agricultural commodities at the consumer level stems from the condition of the general economy. Effective and sustained demand for commodities in the market place has its roots in labor efficiency, balanced production, equitable distribution of the benefits from resource investment and the constructive end use of these benefits. Demand for agricultural commodities is created through the market, either domestic or foreign. This demand, either foreign or domestic, must be reflected through an effective marketing system at the farm level.

The profitable use of agricultural credit may be limited by the market structure, i.e., reliable economic information, commodity standards, facilities, services, including communication and transportation. Thus, the use of credit for providing inputs to improve commodity marketing may need to go forward concurrently with investments for commodity production. If agricultural products do not find a ready sale, at a favorable price, the efforts of the farmer will be lost no matter how effective he may be in planning, organizing and managing the production of the agricultural firm. They will be lost not only to the farmer, but also to the total national economy.

