The Second Coming of Agricultural Credit

Thomas Timberg

In the 1970s and 1980s, considerable development assistance went into agricultural credit projects. Experts believed that subsidized agricultural credit promoted innovation, and that agricultural innovation, in turn, drove economic growth. Despite expectations, none of this occurred in most countries. Any growth in yields took place because of technical innovations, unhindered by absence of credit. Credit provision accompanied most of the surges in the adoption of Green Revolution packages, as in Indonesia, the Philippines and India, but few assigned credit an important role. Further, rather than surges in agriculture "explaining" growth, manufactured exports and even services were better appreciated. Table 1 illustrates that agricultural aid declined from more than 10-15 percent in the 1970s and 1980s to less than 5 percent of total aid today.

In 1973, the Spring Review of Agricultural Credit sponsored by USAID concluded that agricultural credit actually undermined agricultural and economic development.[1] Subsidized credit undermined sustainable financial institutions that were the basis for financial services to agriculture and other industries.[2] Government budget and donor funds were inadequate and often misused. The politically well-connected captured subsidies, and fungibility meant that agricultural credit did not necessarily fund agriculture.

THE SHIFT FROM AGRICULTURAL CREDIT: THE 1980s

Donors and governments moved away from supporting agricultural credit programs slowly, often because of entrenched political interests. Through the 1980s, the multilaterals' policy directions placed heavier restrictions on agricultural credit and the volume of activity

---

[1] Ed. Donald, Gordon, *Credit for Small Farmers in Developing Countries*, Boulder, Colorado: Westview, 1976, is a summary volume. The full message is in Adams, Dale W. and J.D. von Pischke, *Undermining Rural Development with Cheap Credit*, Boulder, Colorado: Westview, 1984.

[2] Adams *et al*., ibid.

Table 1

Agricultural Aid Commitments as Percent of Total CRS/AID Commitments in Nominal Terms

Year	Agricultural Commitments (US$)	Total Commitments (US$)	Percent
1973	772,340	7,762,508	0.099496194
1974	887,015	9,479,630	0.093570635
1975	961,015	8,565,112	0.112201101
1976	1,234,497	10,147,090	0.1216602
1977	1,849,448	11,413,686	0.16203775
1978	2,600,312	15,493,336	0.167834222
1979	2,904,055	16,198,735	0.179276653
1980	3,529,492	21,763,431	0.162175348
1981	2,883,112	20,259,717	0.142307615
1982	3,662,815	21,551,612	0.1699555
1983	3,291,974	2,0697,224	0.159053891
1984	3,778,606	23,833,606	0.158541095
1985	3,767,071	23,051,459	0.163420068
1986	2,812,633	24,542,726	0.114601491
1987	4,685,976	33,853,981	0.138417281
1988	5,824,042	41,414,357	0.140628575
1989	4,877,079	38,130,090	0.127906307
1990	5,136,008	42,330,554	0.121330989
1991	3,712,885	51,496,570	0.072099656
1992	4,187,715	46,300,317	0.090446789
1993	2,693,104	41,021,589	0.065650894
1994	3,703,596	42,766,259	0.086600888
1995	3,629,628	46,802,359	0.077552245
1996	3,932,732	48,448,490	0.081173469
1997	2,976,643	42,014,267	0.070848386
1998	3,211,727	47,461,723	0.067669836
1999	2,954,330	53,404,559	0.055319809
2000	2,827,260	53,422,615	0.052922531
2001	3,048,209	52,021,599	0.058595065
2002	2,274,277	61,421,647	0.037027288
2003	417,261	16,795,373	0.024843807

lessened.[3] Large government credit programs (e.g., Masagana in the Philippines, BIMAS in Indonesia) were decapitalized and reorganized. The Indonesia program switched to nonagricultural microfinance. Pressure to conform to higher prudential standards moved banks away from agricultural lending. In India, agricultural credit fell from 18 percent of bank lending in the mid-1980s to 10 percent in 2003.[4] Figures from Indonesia are roughly constant in percentage terms. Attention to agricultural development decreased for several reasons: environmental concerns blocked older types of agricultural projects like vast irrigation dams; a renewed focus on poverty alleviation and a consensus that in many countries those who cultivated the land were not among the poorest, who were frequently landless; and skepticism about agricultural credit, research, and extension. Support continued for the international network of agricultural research institutions and extension initiatives such as the World Bank's Training and Visit system.

RETURN TO THE MEAN: THE 1990s–PRESENT

International development entities are showing renewed interest in agricultural credit. Dale Adams, a prime advocate of the Spring Review, noted the tendency in a recent article.[5] Elsewhere, GTZ (Deutsche Gesellschaft fur Technische Zusammenarbeit GmbH), a strong advocate of a tough line on credit programs, sponsored studies with the Food and Agriculture Organization (FAO) of United Nations-sponsored work on best practices for agricultural credit.[6] USAID sponsored a conference on the subject in June 2003, along with the World

---

[3] This is involved with the history of Operation Policy 8.30 (Financial Intermediary Lending), last revised in July 1998. It can be found on http://wbln0018.worldbank.org/I..../D8100C2A59A99448525672C007D0956?OpenDocument. The key language is: "Bank-supported FIL [Financial Intermediary Loans] also aim to remove or substantially reduce the use of directed credits, which are akin to interest rate subsidies, as they lead to resource allocation outside market mechanisms. In many borrowing countries, increasing access to credit by specific sectors (e.g. micro-finance institutions or the rural sector) is a major policy objective of the government, and some use directed credit to pursue this objective. A Bank FIL may support directed credit programs to promote sustained financing for such sectors, provided the programs are accompanied by reforms to address the underlying institutional infrastructure problems and any market imperfections that inhibit the market-based flow of credit to these sectors. Such reforms include measures to (a) address obstacles that impede the flow of funds to the credit recipients, or (b) enhance the creditworthiness of the intended beneficiaries through appropriate approaches such as mutual group guarantees. …In some cases (e.g., poverty reduction programs) subsidies may be an appropriate use of public funds. The Bank supports programs involving subsidies only if they (a) are transparent, targeted, and capped; (b) are funded explicitly through the government budget or other sources subject to effective control and regular review; (c) are fiscally sustainable; (d) do not give an unfair advantage to some FIs [Financial Institutions] vis-à-vis other qualified and directly competing institutions; and (e) are economically justified, or can be shown to be the least-cost way of achieve poverty reduction objectives. Subsidies that do not meet these tests are phased out, or are substantially reduced, during the course of the FIL."

[4] "Double Rural Credit, But How," *EPW* Editorial, June 12, 2003. This is an underestimate, since a growing portion of the residual "agricultural credit" is not credit to farmers but to institutions that notionally serve them like the Rural Electrification Corporation. See also S.L. Shetty, "Distributional Issues in Bank Credit: Multipurpose Strategy for Correcting Past Neglect," *EPW*, July 17, 2004.

[5] Adams, Dale W., "From Agricultural Credit to Rural Finance," *Quarterly Journal of International Agriculture* 34, 2: 109-120, 1995.

[6] The Agriculture Credit Revisited Series includes the following: No. 1, Agricultural Finance Revisited, 1998; No. 2, Agricultural Finance: Getting the Policy Right, Elizabeth Coffey, June 1998; No. 3, Best Practice in Agricultural Lending, Brigitte Klein, Richard Meyer, Alfred Hannig, Jill Burseth, Michael Fiebig, December 1999; No. 4, Sources of Funds for Agricultural Lending, T.Giehler, 1999; No. 5, Prudential Regulation and Supervision for Agricultural Finance, Michael Fiebig, 2001; No. 6, Enhancing Farmers' Financial Management Skills, J. D. Heney, 2000; No. 7, Forthcoming 2004.

Bank, the World Congress of Credit Unions, and the British Department for Foreign and International Development.[7] The summary paper from this conference outlined a new, "indirect" approach to agricultural finance:

> The steady withdrawal of USAID and other donors from rural finance over the 1980s was the result of hard-learned lessons about the failures of subsidized credit and the consequent dependence on external sources of funding….Now is a propitious time for USAID and other donors to rethink rural finance with the goal of enabling the deep and broadly-based rural financial markets needed to achieve …growth and poverty reduction goals….Unlike earlier generations of rural finance programming, the approaches here are *indirect*—they do not directly provide financial services. Instead, they create an enabling environment and strengthen institutional capacity in a way that will induce the entry and evolution of competitive providers of rural financial services. The result should be a stable yet dynamic financial sector, capable of operating without subsidy, and freed of the sustainability limitations that plagued earlier rural finance efforts.

This echoes Manfred Zeller's argument that financial institution development should sometimes be subsidized but never borrow.[8] Summary talks from this June 2003 seminar identified initiatives in five strategic areas:

- ***Mitigating Risk.*** The proposed insurance schemes avoid moral hazard and loan guarantees. Despite poor past experience with these, it is hoped that this time they will be carried out correctly.[9]
- ***Improving Information Access and Management.*** Credit bureaus and better use of IT were investigated; both have worked in non-agricultural contexts. Indian banks in particular encourage IT.
- ***Diversifying Products and Services.*** This includes collateral, leasing, warehouse receipts, collaboration with producers' associations, and saving, remittance, and credit services. Such initiatives have a long and honorable record, though they are not widespread.
- ***Strengthening the Legal Environment.*** Accomplished by improving security of land titles and lien registration, as well as facilitating enforcement of credit contracts.
- ***Enhance Value-chain Financing.*** Collaborating with sellers of agricultural inputs and outputs. The innovation proposed for this common practice is not clear, though it makes donors and regulators comfortable with practices concerned.

---

http://www.fao.org/ag/AGS/subjects/en/ruralfinance/afr.html.

[7] Paving the Way Forward for Rural Finance, June 2003, Washington, D.C., http:www.basis.wisc.edu/rfc/agend.html. Quoted material is from "Rethinking Rural Finance: A Synthesis of the Paving the Way Forward For Rural Finance Conference," which lists Michael Carter, Eliza Waters, Brian Branch, Lucy Ito, and Catherine Ford as authors, and is dated March 2004.

[8] Manfred Zeller and M. Sharma, *Rural Finance and Poverty Alleviation*, Washington, D.C.: International Food Policy Research Institute, 1998.

[9] Mike Gudger, Credit Guarantees: An Assessment of the State of Knowledge and New Avenues of Research, Rome: FAO, 1998; Peter Hazell, Carlos Pomareda, and Alberto Valdes, with Joan Straker Hazell, *Crop Insurance for Agricultural Development: Issues and Experience*, Washington, D.C.: Johns Hopkins University Press, 1986.

A variety of pilot efforts were reported, most of which fit the microfinance category. Some innovations were new but untested, such as new forms of crop insurance. There has been little long-term evaluation of most of these initiatives. Despite the apparent trend toward new approaches in the June seminar's summary documents, speakers who favored subsidizing agricultural credit dominated discussions. They felt that returns in agriculture were otherwise too low to pay market rates.

Beyond the seminar, initiatives to revive agricultural credit seem remarkably old-fashioned. There is a drive to rehabilitate agricultural banks, particularly in Asia—this time with less tolerance of nonpayment and more attention to prudential soundness. Credit is being expanded slowly, typically to nonagricultural borrowers. Whether new agricultural credit programs will be protected from politicization is not clear. The Indian government, for example, has forced Indian banks to radically increase credits to agriculture—to the applause of much of the press. One hopes that this will not simply lead again to a lot of bad lending.[10]

Extending microfinance through institutions that serve small farmers and new forms of autonomous cooperatives (the Mutually Aided Cooperative Societies in India) are also getting some attention.[11] In the present regulatory environment, nonperforming loans are harder to accept because of minimum capital requirements and higher interest rates than was previously the case.

In Indonesia, the BRI (Bank Rakyat Indonesia), which has a large, reputable microfinance operation involving several billion dollars, including agricultural lending, has been considering expanding its agriculture business. Some economists in Indonesia argue that demand may not be high; that farmers do not require much credit for routine yearly operations, but only to finance innovations such as planting new crops, or to handle constraints such as bad weather.

The summary of the proceedings of the June seminar clearly represented the opinions of the conference's USAID sponsors. The views of other sponsors and participants differed considerably. There were as noted before many advocates of directed and subsidized agricultural credit at the seminar, certainly influenced by the fact that agricultural credit and agriculture in many industrialized countries are subsidized and directed.

---

[10] See otherwise favorable letter from N.K. Thingalaya in the *Economic and Political Weekly* of June 17, 2004.

[11] "Agriculture Investment Note: Microfinance Institutions Moving into Rural Finance Agriculture," from the Agricultural Investment Sourcebook, http://www-esd.worldbank.org/ais/index.cfm?Page=mdisp&m=07&/p=1.../ More comprehensive treatment in the same Sourcebook is in Chapter 7, "Investments in Rural Finance for Agriculture." Grameen Bank Annual Report 2002, Table on Disbursement of Loans Listed Under Broad Categories of Business Activity, shows that of 14 Billion Taka of loans, 14 percent is in agriculture and forestry and 36 percent in animal husbandry and fisheries. http://www.grameen.info.org/annualreport/2002/1a-dll.html.

Rural Lenders Reinvigorated

In the 1990s, established politicized agricultural lenders (specialized banks and cooperatives) were reorganized into less political, more prudent institutions.[12] Agricultural lenders have begun to concern themselves with prudent management and financial sustainability. The perceived success of microfinance programs similar to the Grameen Bank was a model for a better kind of agricultural finance. Microfinance programs found themselves funding considerable agricultural activity (horticulture disproportionately).

With their new businesslike orientation, revived rural lenders began exploring the market potential of agricultural lending more generally. BRI, which had a successful microfinance division (Unit Desa) with small units all over the country, identified potential agricultural and agribusiness borrowers and changes to undertake to reach them. This was a reaction to a period during which the BRI had been steered away from lending to commercial agricultural production, partially because it would have competed with the government's subsidized, politicized programs. After the monetary crisis of 1997, the Indonesian government had limited resources for such subsidized credit, and banks were pressured to be more efficient. Similar processes occurred with agricultural development banks in other countries.

Elsewhere, for-profit lenders began paying attention to the agricultural lending business. One positive development is the purchase by the Dutch cooperative credit bank Rabobank of several U.S. Farm Credit Services, a network of U.S. agricultural credit banks, because they intend to profit from them.[13] So far, Rabobank initiatives have been through their affiliated foundations and not their for-profit vehicles. Corporate strategists at institutions like Rabobank may have useful insights on the future of developing-country agricultural credit. They apparently still believe they cannot politically or commercially sustain a profitable commercial lending program to agriculturists in developing countries.

Conclusions

In the 1980s, experts alleged that because commercial banks were too urban and focused on the short term to provide financial services for agriculture, they had to be forced into such lending. The banks did not do well, so they were discouraged and stopped such lending. In the 1990s, agriculture and its relation to environmental and antipoverty initiatives were rediscovered. Mainstream donor organizations have recognized the potential of agriculture and agro-industry.

---

[12] Hans Dieter Seibel, "Reforming Agricultural Development Banks," Washington, D.C.: IFAD, 2000; G. Z. Coetzee, D. Graham, R. Ouedrago, R. Hans Deiter Seibel, N. Bereng, T.Z.M. Hijarunguru, T. E. Mutunhu, "Agriculture Development Banks in Africa: The Way Forward," a publication of the African Rural and Cooperative Credit Association at http://www.microfinancegateway.org/content/article/detail/19155.

[13] Ian Bickerton, "Rabobank Set for an "International Offensive," *Financial Times*, Sept. 7, 2004.

Experts now favor increased agricultural lending, but on a sustainable, market-oriented basis. This will require banks to reorient their staff and clients. It is difficult to change a negative agriculture credit culture once it has been established. Change will require the development of appropriate products and procedures. Pessimistic bankers will need proof that the new techniques work, which requires some publicized successes. Those concerned with financial development can help develop appropriate products and train financial institutions to use them. This development will be carried out using

- Research, development, identification, and testing of new products and approaches;
- Training on, orientation to, and dissemination of new products and approaches; and.
- Support for institutions interested in adopting and selling those products.

Though the June 2003 USAID-sponsored Path Forward Conference enabled many people to share their work, they drew from a narrow field of donor-aided projects (NGO or otherwise) and theoretical research. Broader, more commercial experience needs to be studied, discussed, and disseminated.

The first step to increasing agricultural lending is to identify entities in the field, (e.g., moneylenders, input and output traders, NGOs and cooperatives, banks, and government bodies) and examine their methods. It would be especially desirable to identify and analyze successful lending. A great deal of agricultural lending is going on all the time, much of it up and down the subsector value adding chain. Reasonable questions can be asked about the distributional and productive effects of this lending. A recent article published in India points out how much non-institutional private lending persists even where extensive institutional credit is ostensibly available.[14] One might even deduce from this article that such lending might be preferable. To the contrary, it has been argued that such "connected" lending, up and down the value chain, can reinforce exploitive or undesirable social relations. But the most extensive studies where this question has been most heavily examined indicate that this is rarely the case.[15]

The second step is to consider causes of the present situation's unsatisfactory elements. Too little credit may be provided, as indicated by the potentially bankable borrowers who are unserved.[16] It is possible that these potential borrowers are being served, but at excessive interest rates owing to inefficiency or lack of competition.

---

[14] Anita Gill, "Interlinked Agrarian Credit Markets: Case Study of the Punjab," *EPW* August 14, 2003, 3741-3751, or in her book *Rural Credit Markets: Financial Sector Reforms and the Informal Lenders*, Delhi: Deep and Deep, 2000.

[15] Clive Bell, "Credit Markets and Interlinked Transactions," in *Handbook of Development Economics*, eds. Hollis Chenery and T.N. Srinivasan, Amsterdam: North-Holland, 1988, summarizes must previous literature. Clive Bell, T.N. Srinivasan, and Christopher Udry, "Rationing, Spillover and Intelinking in Credit Markets: the Case of Rural Punjab," *Oxford Economic Papers* 49, 4, 1997, pp. 557-585.

[16] Examples of such conditions are in *Preliminary Findings: Microfinance Access and Services: Household Survey*, May 2003, and *BRI Micro Banking Services: Development Impact and Future Growth Potential*, October 2001, both published through the Center for Business and Government, John F. Kennedy School of Government, Harvard University. These two studies, in which BRI loan officers assessed a sample of rural borrowers, found that even using BRI's current standards many bankable unserved borrowers existed, though many

Third, if bankable borrowers exist it is worth examining the obstacles to agricultural lending. It may be that no one is willing to lend, or that specific legal and institutional barriers restrain willing lenders. It might be useful to study lending systems and procedures of potential lenders to see why they are not functioning as desired. Common causes for lack of lending include specific regulatory policies, window guidance from bank supervisors, government-influenced economic climates, or individual bank marketing strategies that exclude smaller borrowers. According to an unpublished survey, the most important factor in determining the volume and sectoral composition of lending in Indonesia is the marketing strategies and accompanying staff incentives of individual banks, generally public sector banks. In India, too, agricultural lending is apparently profitable for banks even though interest rates are capped. Some assert that the problem is not lack of profitability but banks' general disinclination to pursue rural markets.[17]

On the other hand, many observers, including some in the June seminar, focus on elements in the enabling environment such as the security of land titles so that they could serve as security, or the efficiency of court enforcement of debt contracts.

Fourth, we need to consider the potential means for public sector intervention—moral suasion, directed credit, or enabling reforms. Several central banks and supervisory authorities monitor agricultural lending and sponsor meetings where potential lenders and borrowers discuss obstacles to increased lending and share successful initiatives that particular lenders have undertaken. This process sometimes involves heavy moral suasion, as in the case of the U.S. Federal Reserve Banks. Precisely because it is driven by bank supervisors, it is subject to a constraint that more politicized efforts lack. These efforts are generally not popular with bankers in the United States or elsewhere. They are clearly preferable to subsidized and directed credit, subject to market checks, and do not seem to have done much harm to the banks where they have been undertaken. Many banks have found that, as with Community Reinvestment Act, they have eventually located profitable lines of business.[18]

---

were uninterested in taking on debt. The rest constituted a potential market for rural, mostly agricultural, lending.

[17] See previous footnote.

[18] Daniel Immergluck, *Credit to the Community: Community Reinvestment and Fair Lending Policy in the United States*, New York: ME Sharpe, 2004.