

IMPLICATIONS OF AGRICULTURAL CREDIT POLICIES: EVIDENCE FROM FIJI ISLANDS

Pravendra P. Sharma

1. Introduction

This study evaluates the agricultural credit delivery system in Fiji, based on an evaluation of the relevant financial institutions and a survey of 165 commercial farms. The Fijian case illustrates how well intended policy measures have not only been inadequate but have also been incompatible with other structures in the economy, particularly the land tenure system, and have thereby led to undesirable results in terms of channelling finance to small farmers. The purpose of this paper is to analyse agricultural credit policies in Fiji and set forth some policy recommendations for directing more funds to a larger number of heretofore unserved small farmers. The analyses and conclusions drawn in this paper may be of interest to policy makers of other developing countries (notably of the African subcontinent, the South Pacific and other island economies) which have similar agrarian structures and have recently embarked on financial institutional building.

Fiji is a developing country and like most developing countries in the South Pacific, agriculture has traditionally been the mainstay of the economy. Agriculture accounts for about one-fifth of the G.D.P. while subsistence production contributes about 30% of the agricultural output. Though the Fijian economy is based on a free enterprise system, 83% of the land is communally owned, while only 8% is freehold. The Sugar industry is the harbinger of the economy, accounting for 81% of domestic export earnings and providing employment for over 40% of the labour force. Although high priority has been accorded to the agricultural sector, growth in this sector has been sluggish. While G.D.P. grew at 5.8% per annum during the period 1970-78, agriculture grew at only 0.8% per annum over the same period. During this period the Government established the major goals of import-substitution in a wide range of food products, commercialisation of subsistence agriculture and mitigation of the urban-rural income gap, relying on agricultural credit to attain these objectives. However, the objectives set forth have not been realised to any significant extent to-date.

2. Quantitative Overview of the Agricultural Financial System for the period 1970-1980

The major source of agricultural finance prior to the mid-seventies have been money-lenders, shopkeepers and surplus funds generated from farming operations.

The usurious interest rates charged by these non-institutional entities has been as high as 40% per annum though currently it is about 25-30%. In recent years, these informal lenders have been largely replaced by the commercial banks and the Fiji Development Bank (F.D.B.).

Of the total loans outstanding to the agricultural sector, the F.D.B. accounts for about 52%, making it the single largest source of agricultural finance in Fiji as shown in Table 1 below.

Table 1

QUANTITATIVE OVERVIEW OF THE AGRICULTURAL FINANCIAL SYSTEM (1970-80)

Institutions	Loans to Agriculture (\$m) *							
	Total		Of which sugarcane		Other		% of institution's loans to agriculture	
	1970	1980	1970	1980	1970	1980	1970	1980
F.D.B. **	0.8	18.5	0.04	9.8	0.76	8.7	39	47.4
Commercial Banks	0.7	16.3	0.6	10.8	0.1	5.5	3.3	8.3
C.C.S.L.A.	0.03	0.6	0.03	00.6	—	—	100	100
Total	1.53	35.4	0.67	21.2	0.86	14.2		

* Refers to end of year loans outstanding.

** Refers to financial year ending 30th June.

Source: Bureau of Statistics, F.D.B., C.C.S.L.A.

On the other hand, commercial banks and the C.C.S.L.A. account for 46% and 2%, respectively. Table 1 shows that the lendings of the agricultural financial system are largely directed towards sugarcane farming since it accounts for about 60% of the loans to the agricultural sector.

3. Fiji Development Bank

The F.D.B.'s main activity so far has been to make medium and long-term loans for development projects. Since the Bank's charter specifically requires it to make preferential loans to the agricultural sector, it plays a significant role in channelling funds for agricultural purposes relative to other lending institutions. In view of this role, it is also used as a medium by international aid agencies such as the World Bank and the Asian Development Bank to channel funds to small farmers. The F.D.B.'s operations have expanded since its inception in 1968. Loans outstanding have increased by over 19 times, from about \$ 2m in 1968 to \$ 38.9m in 1980 (for year ending 30th June). This increase could be attributed to a combination of increasing demand from borrowers and opening up of new branches in other areas. The number of branches increased from 1 in 1968 to 9 in 1980. During the period 1968-81, equity investment in companies increased from 2 companies amounting to \$ 0.11m to 16 companies totalling \$ 0.89m in 1981.

4. Overall Performance of the Fiji Development Bank

Despite the rapid growth in agricultural lending over the last decade, the size and scope of F.D.B.'s lendings pertaining to agriculture is still small. Of the total potential target group of about 70,000 farmers in the country, only a small proportion (6.1%) of eligible recipients have been reached as of 1980. This compares poorly with other developing countries. The limited impact, scope and coverage of the F.D.B. is also reflected in the slow growth of agricultural output and the ratio of F.D.B.'s lendings to agricultural output which has been constant in recent years. Table 2 shows that F.D.B.'s credit coverage ratio increased from 2% in 1971 to 10% in 1980 in terms of total agricultural output and from 3% to 10% in relation to total agricultural exports, reflecting a poor use of F.D.B.'s loans.

The other interesting point that emerges from the operational analysis of the F.D.B. is that though there has been a marginal decline in lendings to big borrowers, there continues to be a significantly greater concentration on them. In 1976, 64.5 of the number of loans approved accounted for only 23.1% of the value of loans while in 1980 these increased to 73.3% and 24.9%, respectively. At the opposite end of the spectrum, 1% of the farmers got 26% of the total approved in 1976 while in 1980, 1.9% of the farmers got 24.2% of the loans approved in the agricultural sector. This

Table 2

AGRICULTURAL CREDIT COVERAGE RATIOS OF F.D.B. 1971-1980 *

As at end of period	Agri. Output ** (1) \$m	Agri. Exports # (2) \$m	Agri. Outstanding (3) \$m	Ratio (3) ÷ (1) (4)	Ratio (3) ÷ (2) (5)
1971	48.8	37.9	1.0	0.02	0.03
1973	74.4	43.0	1.2	0.02	0.02
1975	112.8	103.1	3.6	0.03	0.03
1977	141.3	113.0	11.4	0.08	0.10
1978	141.1	109.5	14.9	0.11	0.14
1979	167.9	151.2	17.5	0.10	0.11
1980	211.5 @	208.0	20.8	0.10	0.10

* For data pertaining end of period (calendar year).

** Agricultural G.D.P. in current prices.

Refers to domestic exports.

@ Provisional.

Source: F.D.P., Bureau of Statistics.

situation is indeed contrary to the policy of the F.D.B. (under its act) to promote development of small farmers.

At the sectoral level, the proportion of loans given to the agricultural sector has declined since 1976. This decline is more evident in terms of total loan approvals in which its share declined progressively from 69% in 1976 to 44% in 1980 (at an average annual rate of 9.2%). A similar trend was evident with respect to total loans outstanding where the share of agricultural loans declined from 61% in 1977 to 41% in 1980 (at an average annual rate of 8.3%). This happened despite the amendment of the F.D.B. ordinance giving high priority to agriculture, the introduction of the subsidised interest rate scheme in 1974 and an increase in the repayment period from 7½ years to a maximum of 15 years. Moreover, at the sub-sectoral level, of the agricultural loan approvals (in value terms), the concentration on sugarcane increased from 39% in 1968 to 55% in 1979. This concentration has meant that less funds have been made available to other sub-sectors and has therefore not encouraged import substitution in a wide range of commodities.

5. Financial Performance of F.D.B.

The F.D.B. has not been able to meet the rising demand for loans both in the agricultural and industrial sectors due to limited financial resources. The principal source of finance for the F.D.B. continues to be the Government with capital contributions increasing ten-fold since its inception, to \$10.6m in 1980. In the past funds have been made available through a number of other sources including the commercial banks. The F.N.P.F. has been the other major source of finance. However, in future it appears that finance would be raised increasingly in the local market through issuance of bonds and from other internal sources. In this respect, the C.M.A.'s role would be crucial.

In 1980 the accumulated profits were \$0.62m (inclusive of interest charges), representing a margin of 1.6% on loans outstanding. This low level of profitability has limited the F.D.B. in building up reserves and hence its future investing capacity. This has perpetuated its reliance on the Government for finance.

Table 3

INDICATORS OF FINANCIAL PERFORMANCE 1968-1980

	1968	1973	1975	1978	1979	1980
Debt/total assets	0.34	0.32	0.42	0.70	0.72	0.73
Debt/Equity	0.35	0.47	0.84	2.36	2.62	2.77
Long term Debt/Equity	0.44	0.39	0.73	2.2	2.5	2.6
Current Ratio *	0.91	4.7	1.5	4.9	0.75	2.2
R.O.A. % **	— 0.8	1.2	1.21	1.3	1.27	1.33
R.O.E. % #	— 1.2	1.8	2.3	4.0	4.6	5.2
Interest Rate Spread %	N/A	2.7	1.6	2.9	2.7	2.4

* Current assets/Current liabilities.

** R.O.A.: Return on Investment.

R.O.E.: Return on Equity.

Based on operating profits/total assets; Equity includes interest.

Source: F.D.B.

Undoubtedly, a number of factors including rising cost of funds and administrative costs have contributed to the institution's poor profitability (5) as discussed in subsequent sections. In table 3, a number of financial indicators have been used to evaluate the financial performance of the Bank. The figures in the table indicate an underlying deterioration in the financial viability of the institution. The return on equity as measured by $R.O.E. = PT/NW$, where PT—profit after taxes and NW—net worth, has improved (for discussion of different measures of financial performance, see 3, 8, 10, 11 over the period 1968-80, from -1.2 to 5.2, indicating an improvement in the rate of return on its investments; however, return on equity explicitly takes into account the effects of « financial leverage »¹. By using a higher proportion of debt to finance its operating assets, a firm can increase its R.O.E. via the effect of financial leverage². The F.D.B. has over the years financed a higher proportion of its operating assets by using a higher proportion of its debts as reflected in the rising debt/equity ratio (see table 3). Additionally, this trend is reflected when analysing the return on F.D.B.'s investments through the measure of return on assets which takes financial leverage account only indirectly (when profit is measured after interest).

The situation on loan repayment by borrowers has been deteriorating as the net increase in the provision of debts (bad and doubtful) increased from \$ 45061 in 1973 to \$ 0.4m in 1980. Lack of data precludes a clear assessment of the debt situation. Nevertheless, bad debts written off have increased and total bad debts written off between 1975-1980 amounted to \$ 0.3m (or 1.1% of the average loans outstanding)³. The F.D.B. does not compile aging of arrears as a matter of routine, thus the problem of delinquency cannot be precisely determined. As of March 1981, arrears between 3-6 months category affected about 7% of the total loans outstanding, amounting to \$ 2.5m. However, it should be noted that the arrears situation is considerably understated due to « writing back » of loans⁴; it is estimated that about 20-25% of the loans were written back between 1975-1980. The rising arrears and writing back of loans adds to the costs of the F.D.B. The ratio of administrative and supervisory costs (excluding supervision given by Ministry of Agriculture and the F.S.C.) to loans made

1. While an increase in financial leverage increases R.O.E., it also increases risk. R.O.E. gives us a measure of return but ignores the riskiness or viability of return. For details see (11).

2. Return on assets is the ratio of profit after taxes/total assets.

3. The Government wrote off \$ 0.8m accumulated losses in 1983.

4. Rescheduling of loans is not treated as arrears. This may have been done to indicate financial efficiency since once the loan has been « written back » or rescheduled, it no longer appears overdue.

(approvals) increased by 33%, from 0.06 to 0.08 between 1976-1980. However, the administrative and supervisory costs per loan (4) increased from \$ 432 to \$ 621 during the same period. These increases occurred despite an increase in the number of larger loans.

The real interest rates charged by the F.D.B. have been largely negative and low, thereby contributing to the underlying deterioration in the financial situation. In addition, the F.D.B. operates on an interest rate spread of 2.4% (see table 3).

The above performance of the F.D.B. could be attributed to a number of reasons both on the lenders, and borrowers, side. On the lenders, side, the major problems confronting the F.D.B. relate to organisational, administrative, staff and budget constraints. Internal and external co-ordination also need significant strengthening. Presently the F.D.B. does not have a fully organised research department or unit. Hence the ability of the institution to identify growth areas and potential sub-sectors for channelling funds is limited. Further, the Bank does not undertake any impact analysis for evaluating its investment programs and to determine whether its objectives are being met. The financial constraints faced by the Bank are largely attributable to the low and concessional interest rate policies adopted by the F.D.B.

Recent theoretical contributions (1, 6, 9) have suggested that concessional and/or low interest rates coupled with inflation and rising administrative costs not only prevent generation of additional resources for further lending but also channel credit away from the smaller and poorer farmers. The inadequacy of funds is reflected in F.D.B.'s inability to hire professional staff, poor geographic coverage and the fact that on occasions it has had to resort to standby facilities with the C.M.A. and commercial banks and has been forced to cut back on its lendings for farm implements, etc. The problem has exacerbated since the institution of an interest rate subsidy scheme in 1974 for agricultural lending. The underlying purpose of this subsidy is to assist the small farmer in reducing his debt burden and to allow a larger cash surplus for improving his standard of living, thereby achieving a more equitable distribution of income and living stand. However, this objective has not been achieved as the F.D.B.'s penetration in the agricultural sector is limited to the periphery of the sector with little impact on the subsistence subsector. Moreover, as mentioned earlier, the F.D.B.'s lendings have been concentrated largely on big borrowers. It appears that the F.D.B.'s lendings have been governed by the iron law of interest rate restrictions as postulated by Gonzales Vega (7). This is further highlighted by the increasing amounts

of loans going to the sugarcane sub-sector (largely the non-rationed borrowers). The preferential lending to the sugarcane sub-sector is attributable to the fact that the institutions consider lending to this sector a good risk since it is relatively well organised along commercial lines and debts are easier to collect in this sub-sector. In addition, all the sugarcane farmers have titles to their farms, therefore can offer their land as collateral. An assured market and forecast prices also facilitate greater lending in this sub-sector. Owing to this preferential lending, the impact of institutional lending on the growth of other sub-sectors has been minuscule.

In terms of ameliorating the disadvantaged position of the small farmer in Fiji, the introduction of concessional interest rates has been regressive since most of the borrowers are large borrowers who have access to institutional finance. Further, since any subsidy is directly related to the loan size, larger farmers receive correspondingly larger subsidies while a great proportion of subsistence or semi-subsistence farmers go without any credit. My field investigations revealed that small farmers are also excluded by long delays in the processing of their loan applications and increased collateral requirements, both of which significantly raise the borrower's transactory cost. The concentration on large borrowers occurs because a low interest rate inevitably leads to a low interest rate spread which is not high enough to cover the higher costs of providing numerous loans to small farmers. Further, it is cheaper for the lenders to make larger than smaller loans.

Low interest rates have to some large extent influenced farmers' investment decisions, encouraging premature capital-intensive equipment which in turn exacerbates the already high unemployment in Fiji. That such capital intensive measures have been rather premature is well borne out by my field investigations which revealed that 60% of the farmers who had tractors used it for only a total of 4-6 months a year including the time for which they are rented out to neighbouring farms. Furthermore, some farmers are now in the process of introducing special tractors for mechanised cane planting and if this were to be extended on a large scale, the implications for unemployment would be very serious indeed. Low and concessional interest rates also encourage farmers with access to institutional credit to borrow more than the social opportunity cost of credit would justify. This has led to inter-sectoral, interpersonal and regional misallocation of resources, thus perpetuating the dualism between commercial and subsistence agriculture. Larger farmers who have access to credit generally have other occupations and the demarcation between what constitutes their primary and secondary activity is rather thin. Given the low interest rates and the

fungibility of credit, it is reasonable to assume that a significant portion of credit for agricultural purposes leaks into other secondary activities.

6. Concluding Remarks

There has been considerable rhetoric about financing of small farmers not only in Fiji but in other developing countries. Most agricultural finance programs consist of elements of concessional interest rates for promoting small-farmer agriculture. There is, however, little evidence to suggest that increasing amounts of credit have gone to the relatively poorer and smaller farmers despite the various measures such as loan guarantee schemes and administrative fiat adopted. The evidence from Fiji Islands shows that both in terms of numbers and amount of loans given, most of the institutional finance for agriculture has gone to larger farmers particularly in the sugarcane sub-sector while most of the farmers located in the hinterlands and removed from the urban centers have been excluded. The latter group comprises about 73% of all farmers in Fiji. This data evidently points that the low and concessional interest rate policy should be re-examined with a view of developing alternative policy measures for channelling more credit to small farmers.

In contrast to the present policy, the interest rates should be revised upwards to reflect not only the opportunity cost of capital but also cover higher administrative costs and allow a premium for risk. This would improve considerably the overall functioning of the financial market in the country. The higher interest rates would lower the implied subsidy and thus reduce the amount of credit demanded by the relatively more affluent and larger farmers in Fiji. In addition, due to higher revenue, the financial institutions would be more willing to lend to small farmers since they would be able to cover the higher costs of administering loans to new small farmers. The high interest rates prevailing in the informal market in Fiji currently reflect the relatively inelastic demand for credit by individual farmers. Hence, the amount of credit demanded by small farmers would not decline if interest rates were increased. With higher interest rates, on the other hand, there would be greater incentive for institutional savings⁵ in the rural areas since the former would encourage the incorporation of savings into the wealth

5. The high propensity to save in Fiji is evident from the four-fold increase in savings in real terms over the last decade.

portfolio of the individual through domestic financial systems. The impact of the savings on growth would of course be different depending on how it is saved, that is, in what form (6). It should be realised, however, that a higher interest rate would not in itself be a panacea for the financial needs of small farmers.

Other measures which increase and indeed enhance the debt and repayment capacity of the borrower are just as crucial. In other words, the problem cannot be resolved by higher interest rates alone since the inadequate marketing infrastructure, price support, extension services, etc. cannot be rectified by these. Even if the emphasis is changed to productive capacity rather than other collateral or security, it would resolve short-term credit requirements but not necessarily medium- to long-term credit requirements for on-farm investments. One aspect of enhancing debt capacity which has been somewhat overlooked by a number of authors is that in an economy wherein communal ownership of land and free-enterprise oriented financial institutions co-exist, it is virtually impossible for the financial institutions to serve the communal farmers on an individual basis⁶. Farmers who do receive funds from public or private institutions are largely those cultivating secured land and can therefore provide a basis for collateral, thereby reducing loan default risks. It follows therefore that farmers who cultivate unsecured land are automatically excluded from the lendings of both public⁷ and private institutions which have been established primarily to function in a capitalist economy. There appears to exist an incompatibility between the financial institutions and land tenure system in Fiji since a number of farmers wanted and were in need of finance but were inhibited from acquiring it due to the communal ownership of land. Thus if agricultural growth is desired, then the financial system must be made compatible to the land tenure system or vice-versa.

Reorienting the financial institutions to serve the farmers within the existing land tenure system would be tantamount to the establishment of entirely new institutions, an analogy of this being the advent of the Islamic Banks of the Middle East. Such a measure is certainly beyond the administrative and economic resources of Fiji at this point of time. Appropriate changes would therefore be required in the leasing system whereby expeditious issuing of leases is carried out for farmers currently cultivating unsecured land. Unless leases are provided to such farmers, they shall continue to be unable to procure credit from the existing financial institutions and to that an extent be

6. Though land is communally owned, farming is done on an individual family basis; this compounds the problem of lending by institutions.

7. The public financial institutions in Fiji operate on similar criteria as the commercial banks.

excluded from either participating or benefitting from the development process. This point has eluded most economic planners in Fiji.

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LES CONSEQUENCES DES POLITIQUES DE CREDIT AGRICOLE: EXPERIENCE DES ILES FIJI

RESUME

Cet article analyse le système de crédit agricole dans les îles Fiji sur la base d'une évaluation des plus importants établissements financiers et d'une enquête auprès de 165 exploitations agricoles produisant pour le marché. On propose des lignes directrices de politique économique ayant pour but de canaliser une plus grande quantité de crédit pour un plus large nombre d'exploitations de modestes dimensions, jusqu'ici oubliées.

L'exemple des îles Fiji montre non seulement la carence de mesures adéquates de politique économique mais aussi l'incompatibilité entre ces mesures et les structures de base du système économique et particulièrement le système existant de propriété des sols. L'analyse met en relief que la majeure partie du financement provenant de sources institutionnelles a été dirigée vers des exploitations de canne à sucre produisant pour le marché et vers des exploitations prospères de grande dimension. Cette forme de financement a pu être mise à la disposition pour seulement le 12% du marché potentiel: elle a réussi à pénétrer seulement dans la périphérie du secteur intéressé et a eu des conséquences modestes sur le large secteur de l'agriculture de subsistance. L'expérience de la Fiji Development Bank, la plus importante source de crédit agricole dans le pays, a été jusqu'à présent assez décevante. Ces résultats peuvent être attribués à beaucoup de facteurs: il faut rappeler entre autres les difficultés d'ordre administrative, les contraintes de nature budgétaire, l'insuffisante compétence du personnel de direction mais surtout la politique des taux d'intérêt adoptée par cette Banque: politique caractérisée par des taux d'intérêt faible et à des conditions de faveur.

Cette politique non seulement a affaibli les ressources de la Fiji Development Bank mais a contribué à concentrer ses prêts vers de grosses exploitations et vers des exploitations spécialisées dans la culture de la canne à sucre à cause du coût plus faible des transactions de cette clientèle. Cette politique de taux d'intérêt est donc dans une certaine mesure régressive et contraste même avec le but de promouvoir le développement des exploitations de petite dimension. L'autre obstacle d'une politique de prêts plus rationnelle de la Fiji Development Bank a été le système de propriété des sols qui défavorise les paysans plus pauvres en les privant de la possibilité de recourir aux prêts de sources institutionnelles. La plus grande partie (73%) des paysans exploitent des sols de propriété communale sur lesquels ils n'ont aucune sécurité future ni aucun droit juridiquement reconnu par les lois ou par les institutions financières: donc ces paysans n'ont pas la possibilité d'emprunter auprès des institutions officielles de crédit. Pour améliorer les résultats de la Fiji Development Bank et pour augmenter les prêts aux nouveaux demandeurs ainsi qu'aux exploitants de petite dimension l'Auteur envisage une augmentation du taux d'intérêt. Pour résoudre l'incompatibilité de base entre les institutions de crédit et le système de propriété des sols, il faut aussi envisager des modifications adéquates de la situation actuelle: il faut que les crédits soient accordés sans discrimination aux différentes catégories d'exploitations donnant à toutes les mêmes conditions que celle réservées aux exploitations possédant le sol.
