# SUSTAINABLE AGRICULTURAL CREDIT

Beno Boeha[1]

## INTRODUCTION

This morning we were reminded again of the importance of Policy and Strategies in Agriculture. The Prime Minister refreshed our memories as to what agriculture should be. And further, the Acting Minister for National Planning and Monitoring, Hon. Bart Philemon reminded us that we should always plan for economic growth through agriculture. It is imperative to remember that, if we are going to plan for provincial and district levels of economic development, then agriculture must be part and parcel of our development policy and strategies at those levels. If we have acquired financial and technical resources from donors, then we need to ensure that they are properly utilised in the areas of most needed, such as health, education, infrastructure, fisheries, forestry, and agriculture.

## EXPENDITURE PLANNING

My task this afternoon is to present my views regarding the Agricultural Incentives through Sustainable Agricultural Credit. However, I would like to begin by reiterating that every government must have its expenditure planning based on an annual three-year rolling exercise under the National Public Expenditure Plan (NPEP). This policy must be adopted as a tool to ensure that growth in expenditure is directed towards activities which the government has designated as having priority in the National Development Strategy (NDS), as was alluded to earlier this morning.

Many of you are undoubtedly well aware of the aims of the NPEP to link the planning process with the macro-economic policies and the budget, direct public expenditure towards activities that have national priority in the implementation of the NDS, and monitor the implementation of the projects. The current Government has reaffirmed that sustaining agriculture is one of its priorities.

## SUSTAINABLE AGRICULTURAL CREDIT

Just what is Sustainable Agricultural Credit? To be able to give an accurate anwer to this question, we need to know what is supposed to be sustainable. Are we referring to the **agriculture** or the **credit**? This issue is important and very serious, not flippant. I am assuming that it is the **agricultural credit** that is to be sustainable. But is it to be **environmentally, socially,** or **economically** sustainable?

### Environmentally Sustainable

**Ecological Sustainability** is not an issue that should be addressed through credit. This should occur in the design of agricultural projects. Nevertheless, any lender who is supporting a large agricultural project should check on the environmental impacts of the project to ensure that these have been addressed in the project design. If this has not occurred, it may eventually render a project non-viable, by raising costs or making it liable for compensation payments.

### Socially Sustainable

To be **socially sustainable** any loan must be for a productive marketing purpose, and not for personal consumpton. Loans should enable levels of production that would not otherwise be possible.

[1] Director, National Research Institute, P.O. Box 5845, BOROKO, N.C.D., Papua New Guinea.

## Economically Sustainable

To be **economically sustainable**, credit must be subject to the recipient's capacity to repay. Therefore, a loan repayment plan must be bsed on cash flow budgeting of income and expenses. However, this is a frequent problem, particularly where the borrower's education is lacking, and the onus is placed on the lender to be responsible in not overburdening the client.

Often, such agricultural credit needs to be on longer terms than in other business. For example, tree crops can take several years to reach full yield potential. A problem in Papua New Guinea is that the interest rates on loans are far too high for ordinary citizens to afford. The present interest rate climate is not conducive to borrowing for any business, including agriculture and rural development. So where do we go from here?

## NEXT STEP

There are several things that the Government and its policy makers may wish to consider.

### Rural Development Bank (RDB)

The Rural Development Bank (RDB) is the major player among the rural financial institutions in PNG. The public and private commercial banks and other non-banking financial institutions follow its leads and policies. The RDB must undergo changes to ensure that it becomes an effective organisation in its own right. Otherwise, it will fail to achieve its prime objectives and is bound to face a natural death, in due course.

Two objectives are paramount in achieving sustainability of financing, particularly in the rural areas:

- reaching financial self-sustainability; and
- sustaining outreach to the target rural population.

## Financial Sustainability

The long-term financial viability of the RDB, and other financial institutions, which provide funds through such agricultural credit schemes, depends largely on each institution's efficiency, productivity, and support by appropriate policies. They must show that they will be **cost-effective** in the short term, and **profitable** in the long term. This means that the credit management policy must made to support the long-term financial sustainability.

## Privatisation of the Rural Developmet Bank

Generally, the performance of state and donor-sponsored rural financial operations have fallen short of expectations, and many credit programs have become liabilities to the government's finances. On the other hand, it would be interesting to determine whether the profit-driven private sector is interested in taking over the business of **development banking**. It is worth noting that even in capital rich economies, the private sector is usually not very interested in venturing into this area. In a market economy such as that of PNG, any profitable and viable business will be voluntarily set up by the private sector, without State intervention.

### Previous Credit Program

In the past, some trusts were established by either provincial governments or foundations such as the Lik Lik Dinau Abitorea (LLDAT), the UNDP assisted Trust Fund in Goroka, similar one in Bougainville, and several others. However, their impact has not been assessed for some, but not others. Cooperative banking has not worked in PNG, but there should be new ideas and initiatives to establish such institutions as a "Farmers' Bank", "micro financing" or rual financial systems for rural agricultural populous.

The reasons that previous programs have not worked are because of:

- a shortage of resources and poor recovery; and

- rural downturn in, and lack of, support services, including extension of markets. I will touch on the latter in my paper later this week.

### Resource Mobilisation

Rural and agricultural financial institutions may depend on resources that are mobilished through savings, soft loans from donor agencies, market borrowings, retained profits, or government budgetary support. In the past, multilateral funding agencies used to provide soft loans. However, they are no longer interested in such arrangements, because of the failure of the bank to reduce costs and improve recovery.

## NEED FOR CAREFUL EVALUATION

The following issues must be properly identified and addressed before venturing further with new ideas and models for agricultural financing, including the idea of establishing a "Farmers' Bank" or "micro financing".

### Financial Policies

The prerequisites for any successful agricultural and rural-based financial system are the implementation of apropriate financial policy reforms concerning:

- interest rate;
- credit decisions, based on financial return;
- term nature on lending;
- resource mobilisation policy;
- accounting for bad debts;
- expenditure control, based on costing studies; and
- cost recovery, including service charges.

Before consideration is given to the adoption of any credit finance program, these policies **must** be in place.

### Institutional Policies

Financial institutions must have a cost-effective structure and management system in place in order to meet the challenges, and ensure that the venture is financially viable.

The financial and economic viability regarding institutional cost-effectiveness, and a reasonable return on investment in order to have funds for future loans, must be established.

### Viability of Credit Operation

In order to avoid current constraints in this area, the viability of any credit operations at an affordable and commercially profitable interest rate for the thousands of smallholder farmers within PNG is the crux of the problem. This must be properly evaluated and resolved before embarking on any new financial ideas and systems, such as the recent micro financing.

### Resources for Lending

Sufficient resources must be made available or mobilised for lending, for the various agricultural sector activities. If new financial or resource initiatives are going to depend on the Government, then they could easily repeat past mistakes, as occurred with the RDB.

### Managerial Capacity

The tree crop industry corporations must assess their managerial capacities, if they are to take up the responsibility of financing the agricultural sector.

## FINAL REMARKS

If we are to attain any form of sustainable agricultural credit, it will also depend on the attainment of macro-economic, and political stability in the country. Such necessary achievements will ring interest rates down, and allow credit to begin to play a major part in rural development. In turn, this will enble concessional loans to be sought, wherever possible.