

## **BAAC's long term problem (The Nation, Bangkok, 22 May 91)**

A small-scale farmer in the NE region who wants to start a dairy farming, fish-raising or fruit-tree enterprise will need to borrow as much as 200,000 baht. It will have to be a long term loan, and he can expect to be in debt for ten years before the loan is fully paid off. For 200,000 baht the bank could meet the average short term loan requirements for him and 20 or more of his neighbours to cover their recurrent annual costs for growing field crops like rice, maize or cassava. Repayment rates from these seasonal loans are better than from long term loans. And long-term loans, particularly those provided under the terms of a "special project", are expensive to administer. Why bother with long-term loans?

"Administering short term loans is a routine matter for us, and we have almost 25 years of experience," says Mr Suwan Traipol, BAAC President. "But short term loans will never allow the farmers to make a real break with their past, traditional farming activities. To really develop they need long term loans."

So the bank actively encourages long term lending, ie. loans which will not be repaid for at least five years. Interest is charged at one percentage point below the normal rate, currently 11.5 instead of 12.5 percent, with a bigger differential for selected projects which have special developmental significance. Farmers taking part in projects supported by EC funds for example enjoy interest charges of 9 percent. Each branch has a credit officer who specialises in promoting long term lending operations. Many staff training courses and public relations activities focus on activities which require long term loans. At the head office there is a whole division devoted to designing and promoting "special investment projects", intended to provide extra assistance from both the public and private sectors together with particularly liberal lending conditions so as to encourage long term lending. The bank has initiated 25 or 30 new special investment projects in each of the last several years, a total of over 150 so far.

And yet the volume of long term lending is still relatively small. Long term loans for investment in agriculture accounted for 16 percent of all BAAC loan disbursements to individual farmers last year. Special investment projects, for all the work involved in their preparation, account for

tiny proportions of the total loan portfolio. True, the rate of increase is impressive: long term loan disbursements rose by over 20 percent in 1990 compared to 1989. But 26 percent of the commercial banks' farm loans are for five years or more, according to the Bank of Thailand.

Perhaps the comparison is not quite fair, because the commercial banks in general support much larger farming enterprises than those of BAAC's clients. Nevertheless many people both inside and outside the BAAC believe more could be done to emphasise long term loans among BAAC's traditional small-scale clients in order to make a bigger impact on the rate of development of the farm sector. More concretely, the government has proposed to introduce a credit guarantee fund as a way of encouraging long term loans. And a recent Cabinet resolution requires the bank to increase its long term and medium term loans to 30 percent of total lending.

Why don't more clients ask for and get long term loans? Is there some reluctance or constraint within the BAAC, do the bank's operating procedures somehow discourage the field staff from handling long term loans, or is the problem outside the bank's control? Would a guarantee fund help?

Consider first four problems over which the bank has little direct control: land tenure, infrastructure, technical support in the field and markets.

### **Land tenure:**

Like any bank, the BAAC requires some form of security for all its loans. The conventional approach to loan security is to require the mortgage of fixed assets, with a value at least twice the amount of the loan. But mortgage is only possible if the borrower has a transferable land document, normally either a NS3 or full title deed (*chanot*). Many of BAAC's clients do not have transferable land documents, either because they are tenants on rented land or because they have settled in forest reserve areas where most likely they have no land document at all, or at most they may have a "cultivation right" certificate (STK) which is not transferable except by inheritance. About 20 percent of all Thai farmers are thought to be in this situation, and cannot usually qualify for long term loans under the normal regulations of the bank.

There are two options for farmers with no

transferable land documents: they can borrow up to 30,000 baht under normal regulations under a joint liability agreement. Or they can borrow up to 60,000 baht (or 90,000 baht for import substitution or export promotion products) with two people standing as guarantors for their loan.

The joint liability concept requires a minimum of five and a maximum of thirty farmers who plan to borrow for similar farming activities to sign an agreement whereby each of them guarantees each others' loans. The farmers decide on the composition of these groups voluntarily: they should know each other, live close together and be engaged in the same principal farming activities so that their planting and harvesting, borrowing and repayment, periods coincide. More than two thirds of all BAAC loans are secured by joint-liability agreements, but they are mostly short term loans. The concept can be applied to long term loans and for more than 30,000 baht within the framework of a "special investment project" approved by the BAAC Board of Directors.

But even where loan security is based on joint liability, the bank still needs to know that farmers applying for long term loans will continue to have access to the land where they plan to implement their project, and will not be evicted. To provide this assurance, tenancy agreements must cover the repayment period of the loans, possibly 10 years; and farmers in degraded forest reserve areas must have valid land cultivation certificates from the Royal Forestry Department. In practice, few of the farmers in degraded forest areas have these certificates, so most cannot qualify for long term loans even in special projects where security is based on joint liability.

Take the case of the EC-funded rubber project in Rayong and Chantaburi, discussed in a recent article in *The Nation*. A series of special projects was designed and approved to support lending to about 4,800 smallholder rubber growers, with security based on joint-liability agreements. In practice most of the demand for the project is from farmers in degraded forest reserve areas. Even though the natural forest has long disappeared, little of the land involved is covered by land cultivation right certificates (STKs) so technically these farmers are illegal squatters and are subject to summary eviction. BAAC cannot lend to them until their situation is legitimised by the Royal Forestry Department, a procedure which has so far taken three years and is still not complete. The result is that over 2,000

farmers have been waiting since 1989 to join the project and take long term loans, but have so far not been able to do so.

Problems like this can be found throughout the country, except that very few such areas benefit from the efforts of a project supported by an international donor, so progress can be expected to be even slower. The incomplete and slow documentation of land in the degraded forest areas are major constraints on long term investments in the land.

### **Infrastructure:**

From the farmers' point of view irrigation facilities are the main infrastructural problem in Thailand. Not enough land is covered by irrigation systems. Where systems exist they are often underutilised because the water supply is unreliable, and the tertiary canals and water-users groups are not fully developed. And irrigation facilities which are used effectively are often tied to rice production so discourage other kinds of activities. A farmer with a fish raising or fruit tree enterprise is likely to find he has no water during the paddy harvesting season.

Like many Thai problems, this one is most acute in the Northeast where people are poorest and the need for irrigation is greatest. Some BAAC projects have failed because they rested on the assumption that water would be available through an existing or planned irrigation system, where in fact water was not available or supplies were inadequate.

The situation is improving, and the Royal Irrigation Department opens an impressive number of new schemes each year. But opening a scheme is quite different from having it work well enough to support serious investment in the land.

The Northeast Small Scale Irrigation (NESSI) project provides insights into the way in which irrigation schemes can develop. Starting in 1981, the project focussed on seven existing medium-scale irrigation schemes in several different provinces, aiming to repair the main canal systems, extend the system to tertiary canals in the farmers' fields, and create extension procedures and farmers organisations to ensure the water is efficiently and effectively used. Each scheme included 500 to 2,000 households.

According to the judgement of two separate outside evaluators the project was well conceived and well implemented, and the results in for example the Huai

Aeng scheme, Roi-et, were impressive. Farmers were actively cooperating, initiating new enterprises and raising their production and income levels. By 1988 four of the seven schemes were advanced enough to continue with no further special help.

The key point is that even within the framework of a special project supported by special funds, with a professional staff of 40 supported also by a Thai consulting company, getting to this stage took seven years. Admittedly this was a pioneering project and there was a degree of trial and error involved. Progress should be quicker now that basic lessons have been learned. Nevertheless the moral of this tale, as in so many other cases of rural development, is that even when the basic infrastructure is built, using it effectively requires care, close attention, relatively high levels of technical assistance of various kinds, flexibility, patience, and time. Even then, the number of beneficiaries is unlikely to be spectacular.

### **Technical support:**

Some forms of long term lending are relatively simple and require little or no special technical support, training or adjustment on the part of the farmers concerned. The BAAC does fairly brisk business in lending for the purchase of draft animals, power tillers and other kinds of farm machinery, and many of those loans are for periods of five years and therefore count as long term loans. Application and approval procedures are straightforward for both the farmers and the BAAC staff.

But these are not the types of activities which most people think of when they complain about inadequate long term lending. Long term loans are considered necessary in order to accelerate the diversification towards more specialised, higher-value farm products. This means improving existing activities and promoting new ones. In either case, the investment can only be worthwhile if it goes hand-in-hand with some form of technology and knowledge transfer which will normally involve support services for training, on-farm extension and assistance in identifying and penetrating new markets.

BAAC would say that a fundamental problem with making long term loans is not the availability of finance on attractive terms, but the weakness of technical support services and the resulting lack of technical knowledge and confidence among farmers

about the possibilities which exist. In general farmers are not beating on the doors of the BAAC branches demanding long term loans but being turned away. It is the opposite. The BAAC is trying to promote enterprises which require long term loans, but usually cannot meet its own targets.

Two broad observations from the BAAC's experience in implementing an EC-funded long term lending programme in the Northeast since 1987 illustrate some of the problems. The programme includes twenty separate special investment projects spread over most Northeastern provinces and covering a range of activities including tree crops, freshwater fisheries, dairying and sericulture.

The first observation is that in general it is difficult to persuade small-scale farmers to undertake new farming activities which require long term loans. The recruitment and lending targets for the EC programme were extremely modest compared to the BAAC's total lending programme in the region. The target was to lend 100 million baht over a six year period, compared to BAAC's total lending in the region of 7.6 billion baht in 1990 alone. The loan packages were as attractive as BAAC could make them within the constraints of the bank's overall financial situation, with 9 percent interest and in most cases a grace period for repayment. Special arrangements were made to provide technical and marketing support through public and private agencies, and the bank publicised the projects on the local radio and TV stations and with posters and other printed materials.

Despite all this, few of the branches were able to fulfill their recruitment and lending targets for these projects, particularly in the first year of the programme. There are of course many reasons for the shortfall which are beyond the scope of this article. The point for now is that this experience, and the experience more generally in the long term lending programme, provide no evidence that there is a large demand for long term loans which the BAAC is not meeting.

The second observation is that planning and administering an effective long term lending programme which involves transfers of technology to small-scale farmers is extremely demanding. Assume heroically for the moment that the technical recommendations are faultless. Even then, timely supplies of planting materials and other inputs still have to be arranged. Provision still has to be

made for marketing. Having the farmers follow the recommendations requires careful initial training and a series of subsequent farm visits. Although it is popular and often accurate to say that the farmer knows best, this is not always true when the farmer is starting a new enterprise.

Whether in the public or private sectors, the officials responsible for farm visits are also responsible too for a wide range of other activities and implementing an effective system of on-farm technical support has been the single most difficult part of the whole programme. Moreover, in practice the initial technical recommendations are usually not faultless, and have to be adjusted either for the individual farmer with an idiosyncratic soil type or for the whole group.

We can see wide variations both between and within projects in these respects, as shown in a series of articles in *The Nation* over the last year. The Jun Mai Thai company has provided one field worker for every 50 newly recruited farmers involved in the sericulture project in Chaiyaphum, and the high level of contact has resulted in high technical standards. Elsewhere farmers lacking similar supervision have sometimes been unwilling or unable to provide enough good quality feed for their fish or cows, or apply enough fertilizer, or take fire control precautions, or they have planted their trees on steep slopes without taking proper soil conservation measures, and as a result they will lose money in the long run.

## Markets

It may be a cliché, but farmers will not make a long term commitment to an activity unless they are confident of the market. Markets for farm products are inherently uncertain, but the situation in Thailand is particularly difficult.

Market confidence derives from many sources, not only the current price level. Government policies can have far-reaching effects on market confidence, for good or ill. There is ample material for a series of sobering case studies in Thailand. Policies have been fairly consistent in the dairy sector for several years, resulting in a boom in investment and production. The same cannot be said for paddy, silk, oil seed crops or rubber, for example. In each of these cases there have been mainly *ad hoc* decisions, projects and programmes which are publicly questioned all too often by a minister or one of his officials as soon

as the price drops, or which are not supported by properly planned action in the field.

The fresh fruit sector is by most analyses very promising for Thai farmers, and has benefited from modest promotional efforts. Yet exports are constrained by practical problems like the absence of generally accepted grading standards and the inadequate facilities and discriminatory practices at Don Muang airport which the government is apparently unable to solve.

Rubber provides another interesting study. In 1988 when prices were high the government announced a strong policy to increase the planted area, and organisations like ORRAF and BAAC were drafted in to prepare plans for expansion. As soon as prices dropped, even though they were still at reasonable levels by historical standards, high-level ministry officials started to wonder publicly whether further investment was wise. Farmers and officers in the agencies concerned, especially ORRAF, were naturally confused by the policy statements and by the on-again, off-again export surcharge for rubber products which directly affect the prices which they get.

Thankfully the present government is starting to look at these problems in a more rational, systematic way, with talk of a price support fund and a futures market. Whether and how these ideas will work remains to be seen, but in any case they are not complete answers. In the past the traditional lack of trust between the public and private sectors has served the Thai farmers poorly, and any permanent solution to marketing and related investment problems should include serious steps to give the farmers greater power in the market place. Government agencies can play a crucial role in encouraging farmers to organise themselves in order to understand markets better, and deal with the private companies on a more equal footing.

For the time being most farmers are poor, with no access to reliable market information and with no associations to work and lobby on their behalf. Cooperatives are mostly ineffectual in this respect, though there are notable exceptions. There are few farm products where producers associations have been able to lobby strongly enough to extract anything approaching meaningful commitments from the government. Sugar is a rare exception. Under these circumstances how can farmers have the confidence to invest?