AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

FINANCING AGRICULTURAL DEVELOPMENT

THE CARIBBEAN DEVELOPMENT BANK

Sir Arthur Lewis
(President)

I am very glad to have this opportunity of saying a few words about the Caribbean Development Bank, and of discussing our problems with you.

The Bank in Perspective

I must begin by saying a few general words about the Bank, before turning more particularly to our role in agricultural development.

The first point to note about the Bank is that it is a bank. A bank is an institution which is able to borrow other people's money. The layman thinks of a bank rather as a place which lends money, but a bank has little money to lend other than what it borrows, so the prime condition for survival is that it must be able to borrow money.

In our case the money originally contributed by our shareholders will all have been lent by the end of next year. Thereafter we shall have to be able to borrow between US$10 and US$15 million of hard money plus another US$5 million or more of soft money every year from 1974 onwards. These figures follow from the minimum scale of activity that is required to justify our existence. Since we have a very large technical assistance component, for helping our borrowers design and execute their projects, the Bank was designed by its sponsors to cost about US$700,000 a year to run, and can justify this level of overhead only if it invests about US$20 million a year. Nearly all of this will have to be borrowed from overseas. Unless we can attract this kind of amount of money the Bank will not be fulfilling its intended function, and its survival will be doubtful.

Several constraints follow from the fact that the success of a bank depends on its ability to borrow money. As a start, if it is to be creditworthy, a Bank must be seen to be profitable and able to meet its liabilities. Our Bank has no physical assets to pledge against borrowings, and our borrowings carry no government guarantees. As the City phrase goes, we borrow against our balance sheet, and can borrow only if we have a healthy balance sheet.

This is more difficult for the CDB than it is for other international development banks such as the World Bank, the Latin American, the Asian or the African Development Bank, because these others do not lend to private enterprise without government guarantee, while we do. We are therefore liable to suffer heavier losses from defaults than they are, and must carry larger reserves, which in turn have to come from earning a higher profit ratio. We also need large reserves because of our great liability to loss from devaluations or revaluations of one or other of the 15 separate currencies in which we have to do our business.

All this has to be borne in mind when you consider such matters as the interest rates we charge, the amount and types of security on which we insist, the minimum amount we are willing to lend, and so on.

For example, we cannot lend at less than the cost of borrowing. Our policy is to use the interest on our share capital to pay our expenses and build up reserves. Any money borrowed must be lent at not less than it costs us. We do not yet know how much this will be. We note that at the time of writing Jamaica Government five-year loans yield 9 per cent in London; 15-year money would be 10 per cent or more. So we are not amused when we are advised by West Indian Economists that our lending rate to agriculture should be 6 per cent.

Or, to take another example, a US$700,000 a year organisation can handle only about 40 loans a

year, putting into them the amount of technical assistance which our area requires. If we are to lend US$20 million a year over 40 loans, the average loan must be US$500,000. Currently our minimum loan is US$50,000, and this is quite uneconomic to handle. Yet we are constantly urged to reduce the minimum, and devote more of our resources to loans in the US$25,000 to US$50,000 category. If we did this, the Bank would lend very little in aggregate and would soon have to close its doors. What we have done instead is to finance other intermediaries which do not have to be creditworthy in the great financial centres, and which can therefore handle small loans. We have now lent an initial sum of around EC$500,000 to each of the Agricultural Credit Banks in our LDC's (and promoted the formation of such banks in territories where none existed); we have also undertaken to replenish these sums as soon as they are exhausted.

Of course if we lend to institutions which are not themselves creditworthy, and they default, our Bank will itself cease to be creditworthy. When we lend to a government agency, we obtain a government guarantee. However, most of our LDC members have no reserves, and are not even balancing their recurrent budgets, so they would be extremely embarrassed if we had to call on them under their guarantee agreements. We have therefore to protect the Bank by laying down rules for the financial conduct of the agencies to which we are lending money, so that they will be in a position to meet their obligations without having to call upon their governments. Fortunately for the public, this "banker's approach" to the situation also corresponds with the public interest. Public enterprises are very badly run in this region, and are very much in need of injection of the kinds of financial and administrative discipline which every Bank loan brings with it.

I have to start by emphasizing that we are a Bank, and will come to nothing unless we can establish the degree of creditworthiness which will enable us to borrow up to US$20 million a year. People in these parts are not used to public institutions which have to earn international creditworthiness. They are used to getting foreign aid on easy terms, without much regard to what they do with the money, and are a little shocked by the "arrogance" of the CDB in making strict rules and insisting that each project must pass strict tests. We hope that our public commentators will begin to realise that a Bank which borrows in commercial markets is quite different from a foreign aid agency, and will begin to reflect on what this must mean in shaping banking policies.

The Situation in Agriculture

Next I must say a few words about the agricultural background against which we have to operate, remembering that for the time being our activities are concentrated in the less developed member countries of our region.

At present, agriculture is a dying industry. Cocoa is on the way out. The banana output is down, and there is a note of panic in current discussions. Arrowroot and cotton were nearly out, but may revive if we find mechanical harvesters. Sugar has almost disappeared from the LDC's; the recent price increase is a vigorous shot in the arm, but future sugar output remains a highly doubtful speculation. We do not know whether food production is keeping up with population, but we can see that food imports mount every year, especially imports of meat.

The main cause of this crisis in agriculture is also clear: our costs of production are our of line with international prices. Before the war this statement would have had no meaning, but the agricultural situation in these parts has changed drastically since the second world war. Before the war agriculture was profitable whatever the level of world prices might be, since money costs simply adjusted to world prices. If prices were high, then wages, salaries and rents were high. If prices fell, then wages, salaries and rents were reduced. But nowadays agricultural costs are not determined by agricultural prices. The agricultural labour force is only 20 per cent of the labour force in Barbados or Trinidad, and less than 40 per cent nearly everywhere else. Agricultural wages are determined by what men can earn in urban occupations; salaries are determined by the brain drain; and the value of land is influenced largely by its potential value for urban development. Small farmers, or their sons, will not stay on the land unless it yields a near-urban income. In this new situation our agriculture must drastically increase its output per head, or it will disappear.

Fortunately for us the technical possibilities for improvement are great. First there are the biological possibilities; we get 300 pounds of cocoa per acre instead of 1,000; 800 pounds of maize instead of 4,000; 4 tons of bananas instead of 12 tons; miserably low yields of milk; and so on. Then there are the opportunities for mechanisation. Australia produces sugar much more cheaply than we, although her wages are several times as high. We used to be afraid to mechanise for fear of displacing labour. Now the boot is on the other foot; if agriculture does not mechanise, no labour will be made available for it.

The subject of productivity is closely tied to that of farm size. There are situations where output per acre rises as farm size falls. However, our interest is in output per head, since we have to compete with urban wages, and output per head is almost always lower on small farms than on medium sized farms with comparable soils and crops. It seems now generally to be recognised in the West Indies that farms of five acres are a waste of resources - except for vegetables and flowers, and places where you can get three cereal crops a year. The farmers recognised this even before our governments, and have been abandoning such units for a generation.

The West Indies has too many farms at either end of the spectrum of size: too many small farms and too many large farms and not enough in the middle range of say 20 to 100 acres. The large farms in the Windward Islands include quite a lot of cultivable land which is not cultivated, mainly because the owners feel that it is not worth the trouble, having regard to labour problems, or the income tax, or market uncertainties or what you will. Some of these farms should be cut up into middle sized farms, on which intelligent young men, with a farm school background, and some machinery, may make as good a living as their urban friends.

The Bank cannot lend soft funds to purchase land. These funds are voted by the Parliaments of developed countries, which are very sensitive on the subject of foreign aid. They will not permit their taxes to be used *to line the pockets of rich landowners.* They also want these funds to stimulate their own exports, and therefore rule that every time a project is financed by their funds, their nationals shall have the right to bid for contracts. Land purchase simply does not meet the normal rules laid down for the use of soft money.

We could borrow money on ordinary commercial terms and lend it to the governments to purchase land. But we would have to be repaid over 10 to 15 years at 8 per cent or more, and they have more sense than to get into this. In fact, nationalisation is not normally done by paying cash; it is done by issuing government bonds. Governments do not have the cash with which to nationalise industry; and if they had, spending it in this way would simply promote giant inflations. So we have been more than surprised to hear the Bank criticised by some of our economists for not lending money to the governments for land acquisition.

We have indicated that if the governments acquire land for the purpose of creating medium size farms, we shall be very happy to have our technical staff participate in drawing up farm plans, and also to provide 80 per cent of the money required for infrastructure, equipment and buildings. We are doing just this for a new farm programme in Antigua, which is creating 100-acre livestock farms, and we are constantly seeking out new projects of this kind.

Agricultural Programmes

I am now reaching into the Bank's programmes for agriculture, which are still in process of being defined. I have mentioned our loans to small farmers through the Agricultural Credit Banks, and our loans for the equipping of new medium sized farms. Before going further I must look at another of our constraints.

As mentioned earlier, the Bank is geared to lend about US$20 million a year, spread over about 40

projects, averaging therefore about US$500,000 a piece. It is quite a small sum of money. Gross capital formation in this region is presumably more than US$400,000,000 a year, against which our US$20 million is hardly noticeable, unless it is very strategically employed.

The governments which set up the Bank were very conscious of this, and wrote two important constraints into our charter. One is that we are a bank of last resort: we must not lend money for purposes for which money could be obtained from other sources. We do not, for example, lend money for working capital, since that is what the commercial banks are for; nor for short term requirements like replanting bananas, or buying fertilizers; nor for the purchase of the kinds of vehicles and equipment that can be obtained on hire-purchase terms. Our speciality is long-term lending with favourable periods of amortisation.

The second constraint is that the Bank must act in accordance with *sound development banking principles*. This means that we are not there just to lend money. A commercial bank will lend you money for anything - including to go on a vacation - if you can provide adequate security. But to borrow from a development bank you must establish that the proceeds will be used to raise the national income, whether by increasing the use of fixed capital, or by introducing new technology. Unless the proposal meets this test, it is not eligible. Development banks operating in LDC's have quantified the test to mean that an investment is not eligible unless, when direct and indirect benefits and costs are all included, it will yield at least 9 per cent, since capital is scarce in LDC's and has a marginal product of at least 9 per cent.

Working from these constraints in the charter, and from the very small sum available, the Bank's agricultural lending is confined to projects involving additional fixed capital or new technology. We do not finance any agricultural enterprise which merely expands the area under a crop, without involving new methods that will raise productivity. Most of the agricultural credit already available goes for this purpose. Our Bank does not compete with this credit; we supplement it by confining ourselves to introducing the new technology without which our agriculture is doomed to die.

Since most of our farmers are not skilled in new technology it falls to the Bank's staff to spend enormous time on making farm plans in detail - where this internal road will run, where to put a water pipe, what and where to plant in each of the next five years, what varieties to plant, what fertilizers and pesticides to use, what the detailed capital and recurrent costings will be, possible cash flows over the next 15 years and so on. Each of our agricultural projects is enormously expensive in terms of highly skilled staff time, not only of agronomists but also of economists, accountants and lawyers, and since these projects average only about US$100,000 they are totally uneconomic as a banking operation. Fortunately we are able to meet this technical assistance side of our activities out of a UNDP grant.

The Bank is achieving quite a breakthrough in this field. As we know, the technical possibilities exist for very large increases in productivity. What we have to do is to persuade the farmers to exploit these opportunities, with the financial support of the Bank, and we are gratified by the response which we are beginning to get. We are still having to make most of the running: to seek out farmers who have land that can be developed, and to persuade them to borrow from us for the purpose; but we are beginning to make headway. We lend at 8½ per cent, and what is more important, allow grace periods and much longer repayment periods than the commercial banks will offer. So finance is not an obstacle to the success of our programme.

We are willing to finance any crop which the farmer thinks is going to be profitable. We understand that plans are on foot to have the Heads of Government Conference lay down which islands may grow which crops, and the Bank will of course respect whatever decisions the governments may make. In the meantime the Bank has no expertise with which to make such a plan of its own; and even if it had, is not authorised to impose any such restrictions on its member territories.

The Bank, accordingly, finances anything that involves the use of better equipment or higher level technology, and which seems likely to be profitable. Nevertheless we have our favourites. We are pushing

our borrowers into orchard crops, persuading them to plant 20 acres of mangoes and 20 acres of avocados, in addition to the current staples. One of our agronomists spends all his time working up applications for money to plant vegetables. Another spends all his time on schemes for livestock production. They will soon be joined by a Marketing Officer, with a particular interest in these new fields. This is hard work; we are not giving away money. The borrower will have to repay, over 10 to 15 years, and meanwhile we hold a mortgage on his land. So the Bank cannot achieve results faster than the farmers are prepared to go.

We are also working on the governments to borrow soft money for agricultural infrastructure - for feeder roads, land reclamation, terracing, water conservation and so on. We are pushing the concept of the Land Authority, and have on our staff an agricultural engineer with special expertise in civil land works. But we have not yet had a bite.

Part of our problem is that in most of our LDC's the public has already accepted the idea that agriculture is doomed. British Honduras and Dominica are the only territories where I personally have encountered some public confidence in agriculture, and it is not surprising that we have received more farm applications from these two territories than from all the others put together. In the Bank we do not share this lack of confidence. We see immense opportunities for profitable investment in agriculture, using new technology, and we are concentrating on trying to sell these possibilities to the farmers and governments of all our territories.