FINANCIAL INTERMEDIARIES AS A MECHANISM TO FACILITATE THE INTEGRATION OF PRODUCTION AND MARKETING IN THE AGRICULTURAL SECTORS OF SMALL ISLAND STATES

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Introduction

This paper deals with the potential role and functions of the financial intermediary as a key agricultural sector institution for small-sized island states, with special reference to the Caricom Region. A small-sized island state in this context is defined as a territory, whether independent or internally self-governing, surrounded by sea with an indigenous public sector but severely limited by quantity and quality of resource (particularly suitable land for development, mining deposits, skilled manpower and so on) and size of domestic market. Consequently, it becomes highly dependent on, and influenced by external support.

A financial intermediary is defined as an indigenous banking institution which lends to various economic sectors - agriculture, manufacturing, tourism, services - for productive enterprises on a medium and long term basis mainly, but depends heavily on flow of funds from outside the economy, coming principally from major regional and world lending sources including bilateral aid agencies. As a result, its policies may be influenced by the loan conditions set by its creditors and may operate for some time within the procedures of the international banking system.

Financial intermediaries normally rely heavily on outside sources of funds in early stages of operation, because of the acute shortage of available surplus revenue from the public sector, the competition given by Government for domestic savings in public institutions (National Insurance and Provident Fund) and, in addition, the weight placed by non-national banks and some indigenous credit agencies on consumer credit and lending for short term commercial activities.

Financial intermediaries may not be controlled or directed by outside influences because of their dependence on external sources of funds. That control is basically designed to ensure the development of a viable institution, founded on prudent lending policies to establish credit-worthiness, to be supported by the consolidation of a growing portfolio of successful projects with linkages which is the impact of the institution on sectoral growth and development. The objectives and lending policies of that type of institution which prescribes direction are generally set locally by the Ordinance under which it operates and the decisions of its Board of Directors. Its flexibility to operate as a sound credit institution within the framework of local conditions is principally the function of its management.

It may be argued that this is not exactly the case since the conditions imposed by outside creditors (regional and international development banking institutions and bilateral lending agencies) normally limit the speed and scope of the movement of credit. On the other hand, a counter argument, which is quite sound, states that the past experience of indigenous sector-lending institutions in the Caricom Region is not good (high percentage of bad debtors and a high incidence of funds not used for the purpose of the respective loans). The revitalization of these institutions together with the birth of new ones from 1971/72 since the inauguration of the Caribbean Development Bank (CDB) must be accompanied by prudent policies and accountable procedures. The emphasis must be on scientific appraisal of project proposals, continuous supervision of work being done during implementation and evaluation of on-going operations. This is what is sometimes considered to be burdensome. However, with a bad history, these institutions have to establish an impressive record if they are to attract funds from regional and international banking institutions, bilateral lending agencies, the public sector and very important, the indigenous private sector (rural as well as urban). If this record can be established early, then whatever constraints that may be imposed by outside sources of finance must be seen as short term. A sound and developing financing intermediary is expected to generate some income from the recycling of funds available to it for on-lending purposes, and should be able to attract domestic savings from public and private sources. This may be achieved between five to ten years of full operation. It is, therefore, at such a stage that an effective role in the integration of agricultural production and marketing can be expected by financial intermediaries.

Establishment and Role of Financial Intermediaries

In the Caricom Region, financial intermediaries are described as Agricultural and Industrial Development Banks, Agricultural Development Banks, Development Banks, National Development Corporations and Development Finance Corporations. Variations of these also exist. This paper, however, is confined to those engaged in lending to the agricultural sector.

Some of these institutions were established and in operation before 1971/72. With the introduction of an agricultural credit policy for small farms by the Caribbean Development Bank in 1971, the existing financial intermediaries in the Less Developed Countries of the Caricom Region were given the opportunity to reshape their policies and broaden the scope of their activities. This was facilitated primarily by lines of credit offered to these institutions under the CDB Farm Improvement Credit Scheme. In other territories, some credit functions were carried out by agencies within the administrative arm of Government, sometimes a government agricultural agency or a government controlled board - Agricultural Loans Board. Where distinct institutions did not exist, these were created, under law, to take advantage of the availability of loan funds from this regional source for a specific agricultural programme to activate production and marketing of crops, fisheries, forestry and livestock. This line of credit is aimed at supporting and expanding the efforts of the financial intermediary by providing medium and long term finance, including technical assistance in the preparation of farm plans, primarily for farmers' investments of a new and incremental nature, with the basic objective of expanding national agricultural output, increasing farm productivities, raising and stabilizing farm incomes and so on.

These new institutions came into operation during the period 1972/75. The first Farm Improvement Credit loan was made to the Agricultural and Cooperative Bank in St. Vincent which was established under law in 1966. It replaced the government-sponsored agricultural credit which was formerly provided for annually in the budget and loaned to farmers and fishermen through Agricultural Credit Societies.

The first financial intermediary to be set up with the support of the CDB Farm Improvement Credit Scheme was the Dominica Agricultural and Industrial Development Bank and the last was the Antigua and Barbuda Development Bank. Details on the establishment and operation of some financial intermediaries in the Caribbean Region are set out in Appendix 1.

Generally, and in very broad terms, the objectives of most, if not all of these financial intermediaries, are to encourage and foster the development of agriculture and industries connected therewith and to mobilise funds for the purpose of such development. These objectives fitted very clearly with the agricultural credit policy of the regional development bank (CDB) and were, therefore, made easier the mobilisation of funds from that source. In particular, the Farm Improvement Credit Scheme is biased strongly towards small scale agriculture.

In the Caricom Region, it is this part of the structure of agriculture which needs specific emphasis for development. If we examine the structure of agriculture of the LDCs of the Caricom Region in terms of the distribution of farm units in group size categories and acreages occupied by each size category, we find that the ECCM States together have about 91 per cent of all their farm units in sizes of less than 25 acres, occupying about 43 per cent of the cultivable land resources. A good illustration of a high proportion of small farmers in the farming population is one of the most agricultural-oriented territory in the LDC group. Dominica has about 97 per cent of farm units in sizes of less than 25 acres, and these together occupy about 38 per cent of the cultivable land resources. In the case of Belize, about 78 per cent of farm units are in sizes of less than 20 acres and occupy only 2.4 per cent of the cultivable land resources.[1]

The special case which must be made for deliberate policies and special programmes to move the small farming sub-sector of agriculture is based on the following grounds. These are not all.

(i) The significant contribution which the small farm subsector has made and can continue to make, but at a faster rate of growth, toward domestic food production and consumption, thereby enabling import displacement.

(ii) Its positive impact on growth of real incomes and employment

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[1] Caribbean Regional Study, Volume III: Agriculture, Table 1.12.

opportunities within the rural communities.

(iii) Its flexibility in allowing for change in product mix to support public efforts to broaden the agricultural base through diversification.

It is, therefore, postulated that deliberate policies and the specific programmes which emerge can best be implemented through the effective presence and judicious work of a financial intermediary which combines the processes of production and marketing of agricultural output.

Credit must be considered as a financial instrument to achieve the purposes of agricultural policy. At the same time, agricultural policy must be harmonious and compatible with development plans if these are to succeed. Consequently, agricultural credit cannot be administered in isolation, but as a mechanism closely related to other aspects of the development process. On this basis, therefore, the goals of agricultural credit can be summarised as follows:

(i) To make changes benefiting a broad sector of the rural population.

(ii) To broaden opportunities for increasing production and productivity and to generate agricultural employment.

(iii) To extend credit to as large a proportion of the farming population as is possible and to new producers also, and, in addition, to move farmers as quickly as possible towards regular institional credit with opportunities for rural savings.

(iv) To promote or strengthen the grouping of farmers into associations of various kinds, particularly in the area of marketing.

(v) To introduce and improve coordination between organizations within the agricultural sector and those providing supporting services so as to achieve greater impact of credit programme on the agricultural sector.

(vi) To rationalize the use of financial and technical resources by applying them in areas where the greatest economic advantage can be gained.

(vii) To ensure the maintenance of the real value of natural resources of the territory.

This paper makes out a case for the role of financial intermediaries as the mechanism to facilitate the integration of the processes of production and marketing in agriculture and deals with the proposal under the following heads:

(i) The experience of traditional commodity associations in coordinating production and marketing.

(ii) The institutional need for rationalizing the use of scarce manpower resources in small economies.

(iii) Credit in relation to other services.

(iv) The selection of financial intermediaries.

The Experience of Traditional Commodity Associations in Coordinating Production and Marketing

The experience of the traditional commodity associations, particularly the Sugar Producers' and Banana Associations, illustrates how a principal objective of export marketing can be integrated with the provision of credit, extension and input supply services under one management structure. This proved successful in the Sugar Industry as it was basically confined to relatively large and medium scale producers.

However, in the case of the Banana Industry, the experience has been somewhat different. The conduct and performance of the Industry demonstrated that there are opportunities where management, administrative and technical manpower resources within an economy can be effectively utilized to provide a combination of essential services which are linked. The Banana Associations of the Windward Islands have been able to undertake the organization of marketing for export successfully and at the same time, provide some measure of extension services with limited short-term credit facilities to existing farmers. Credit needs are limited to specific farm operations carried out by existing farmers. Assessments of need are made on past production performance, with supervision by a small field staff (largely with no formal technical training) and collection through sales at the major marketing outlets - the processing (boxing) plants. The supply of credit for farm development (expansion and improvement) comes mainly from indigenous intermediary financial sources outside of the structure of the Banana Industry.

This experience clearly suggests that the possibilities for integration of production and marketing through an appropriate institution are real and the practical application can be successfully exploited, given the will and commitment to do so. Additional information is provided in Appendix 2.

What, therefore, has to be worked out for other situations of a similar nature is at what stage this essential linkage may be established in one institution and, then, the mode of constructing an integral package and the methods to be employed to achieve the desired results.

The Institutional Need for Rationalising the Use of Scarce Manpower Resources in Small Economies

It is well understood that in small-sized economies, such as the LDCs in the Caribbean Region, skilled manpower resources are relatively scarce. It is even more acute in such areas as business management, financial analysis and accountancy. These skills are essential for the effective and efficient functioning of any financial intermediary, commodity association or statutory corporation.

In small-sized economies as this paper refers to, the private sector is relatively weak and the developmental role of Government is inescapably broadened. The public sector has to engage in many activities which are normally designed to promote harmonious sectoral growth and, through linkages, overall economic development. This it does principally through the creation of statutory bodies.

However, with the limitations imposed by the inadequacy of manpower resources both in terms of quantity and quality and the relatively low level of public revenue which can be allocated for the recruitment of management and technical personnel, it becomes rational to consolidate institutions with overlapping functions and linkages under one umbrella. This enables the employment of competent staff in the crucial institutions serving the developmental sectors of small-sized territories.

Where there are many institutions with overlapping functions already operating in territories, it may not be possible to integrate them. Institutions usually, over years of operations, build their independent empires and establish their own personalities which cannot be reduced with ease. However, the effort can be made, bearing in mind that the objective is clearly to optimize the use of scarce manpower resources and to streamline operations thereby saving in costs.

In some territories where this situation does not exist and plans are in the pipeline for setting up financial intermediaries, it is recommended that their functions should be broadened to undertake the task of deepening and broadening of credit for production as well as the marketing of the output produced through supply of credit. Opportunities for this innovative approach, apart from the on-going experience of the Development Finance and Marketing Corporation of Montserrat, are expected shortly to exist in the Cayman Islands, Turks and Caicos Islands and the British Virgin Islands.

Credit in Relation to Other Services

The need for an integrated approach to rural development is quite widely recognized but the choice and operation of the mechanism to accomplish this end present a challenge. To effect such conversion, the complex and interrelated elements affecting rural production must be made available in a comprehensive package of services.

Assuming that a credit programme provides technical assistance which is supported by an extension service, and secures an adequate supply of input through close liaison with commercial and other sources, the minimum package of essential services required to stimulate agricultural production, in addition to the provision of credit, must include adequate marketing arrangements.

A credit service, through a financial intermediary, is likely to be most successful with small farmers, if it is coordinated with marketing, and these are operating harmoniously so that 'the right arm knows what the left arm is doing'. The linkage between the credit function which is to provide the tools for production and the market function which is to provide the incentive for production should be encouraged.

It must not, however, be accepted without research into past experiences, that integration of the functions of supervised credit with the functions of effective marketing of agricultural output within one institution is the answer for solving some of the key problems of agriculture in developing economies such as those of Less Developed Countries (LDCs) of Caricom. The failure of the Peasant Development

Office within the Antigua Ministry of Agriculture to sustain its operations in credit and marketing should be examined to determine cause and effect, and how the experience which emerges can be used in formulating future plans in this direction.

The Selection of Financial Intermediaries

It can be argued that credit should be handled by a specialized institution and that financial intermediaries should handle credit and credit only. However, no matter what is told to the farming population on how to improve yields through some method, some additional investment is usually involved. It may strictly be a case of employing more man/woman hours on the farm to apply some conservation measures, or using a particular chemical to control pests and diseases, or to buy a piece of equipment to apply the material, or to use a particular type of seed or planting material. Funds are, therefore, required. With traditional low savings in rural areas, the need for credit arises. Experience shows that the need exists whether the demand for credit is subject to specific conditions from the borrower's point of view. Consequently, the financial intermediary is an important mechanism for generating additional production capacity in agriculture.

However, an investment in producing any farm output is not secure and not successful from both the borrower's and institution's point of view until it can be satisfactorily marketed at a price to bring in returns to provide adequate rewards for effort. With limited manpower in small sized territories, it seems reasonable to suggest the inclusion of both credit and marketing functions under one organization so as to integrate production and marketing carefully.

There are three basic ways in which financial intermediaries can be used to integrate the processes of production and marketing. The choice of any or a combination will depend on particular local conditions. However, they have been in operation and are worthy of consideration.

(i) Financial intermediaries providing credit for production and engaging in marketing on a contract basis. The Development Finance and Marketing Corporation (Montserrat) is one example.

(ii) The financial intermediary lending for both production and marketing activities, but in the case of the latter, emphasis is on marketing enterprises related to the product mix for which it lends.

(iii) The financial intermediary lending principally to sub-sectors provided with satisfactory marketing arrangements.

The alternatives proposed, if found applicable in any situation, can undoubtedly be modified. In the case of the financial intermediary engaging in marketing, production can be directly promoted. There is also strong opportunity for relaxing on security requirements in lending since the institution can collect at sale. This is more so if the product is a specified one, to be marketed through the institution only. The real problem here is one of ensuring that products purchased by the financial intermediary are sold and the institution can generate an operating surplus to keep it viable. In addition, it must ensure that it is not a dumping ground for any output produced from loan funds, irrespective of quality. These are some of the areas which will require specific attention by management if this method of integrating production and marketing is to be pursued by a financial intermediary.

Where the financial intermediary provides credit for both production and marketing activities, it should be expected to give priority to the marketing activities which directly relate to the product mix which it promotes through lending. In addition, it will have to ensure that the marketing enterprise to which it is lending has the capacity to market the products satisfactorily, and does have access to these markets. Some close monitoring by the financial intermediary is implied.

This alternative offers an opportunity for financial intermediaries to promote farmers' cooperatives where they lend to small farmers, particularly on a crop lien basis and for food crop production. The institution will, therefore, have to be involved in the organization and management of market cooperatives and to provide necessary technical assistance when required.

Where the financial intermediary lends principally to sub-sectors with satisfactory marketing arrangements, the scope of lending may become limited and the promotional efforts of the institution, in keeping with public policy, could be diluted. However, the institution may have the leverage to force marketing organizations to improve their operations to the satisfaction of the farmers so that it can lend to them. It may also be able to identify production possibilities which need marketing attention and, therefore, initiate market research efforts with public support.

No specific recommendations are put forward in this paper. The intention is to provide sufficient material on the subject to allow for constructive discussions on the use of financial intermediaries as the mechanism to facilitate the integration of production and marketing in agriculture. A practical illustration on integrating production and marketing in the agricultural sector through financial intermediaries is shown in Appendix 3 and may be used as a model for consideration.

This illustration, presented in a diagrammatic sketch, shows marketing function included in the structure of the operations of the financial intermediary. Nevertheless, the choice of alternatives is left open, with selection dependent on the number of marketing institutions in operation, the managerial and financial strength of the suitably identified intermediary and the will to consolidate the two functions in one major institution, even at the risk of resistance from influential quarters.

APPENDIX 1. Details on Establishment and Operation of Some Financial Intermediaries in the Caribbean Region

Country	Financial Intermediary Serving Agriculture	Year Established	Principal Aspect of Agricultural Operations
Antigua	Antigua and Barbuda Development Bank.	1971 (came into operation 1974/75)	Providing short, medium and long term credit to small farmers.
Barbados	Sugar Industry Agricultural Bank.	1902	Short and medium term loans to sugarcane plantations with ten hectares or more for sugarcane and other crops including livestock.
	Agricultural Credit Bank	1937	Financing small holders (not exceeding 10 hectares) including tenants (provided they can offer houses as security) and Cooperatives.
	Barbados Development Bank	1969	Providing medium and long term loans for increasing agricultural output.
Belize	Development Finance Corporation	Revitalised in 1973	Providing medium and long term loans for crop, livestock, fishery, forestry and agro-industry development. Operates a special Rural Development Small Farmer Loan Scheme preferably through Cooperatives or other farmers' groups.
Dominica	Agricultural and Industrial Development Bank	1971	Providing medium and long term loans, up to 10 years, for crop, livestock, fishery, forestry and agro-industry enterprises.
Grenada	Grenada Agricultural and Industrial Development Corporation, formed through a merger of the Grenada Agricultural Bank, Grenada Development Bank and the Grenada Development Corporation	1975	To undertake all agricultural credit, including that operated by marketing bodies.

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APPENDIX 1 (continued)

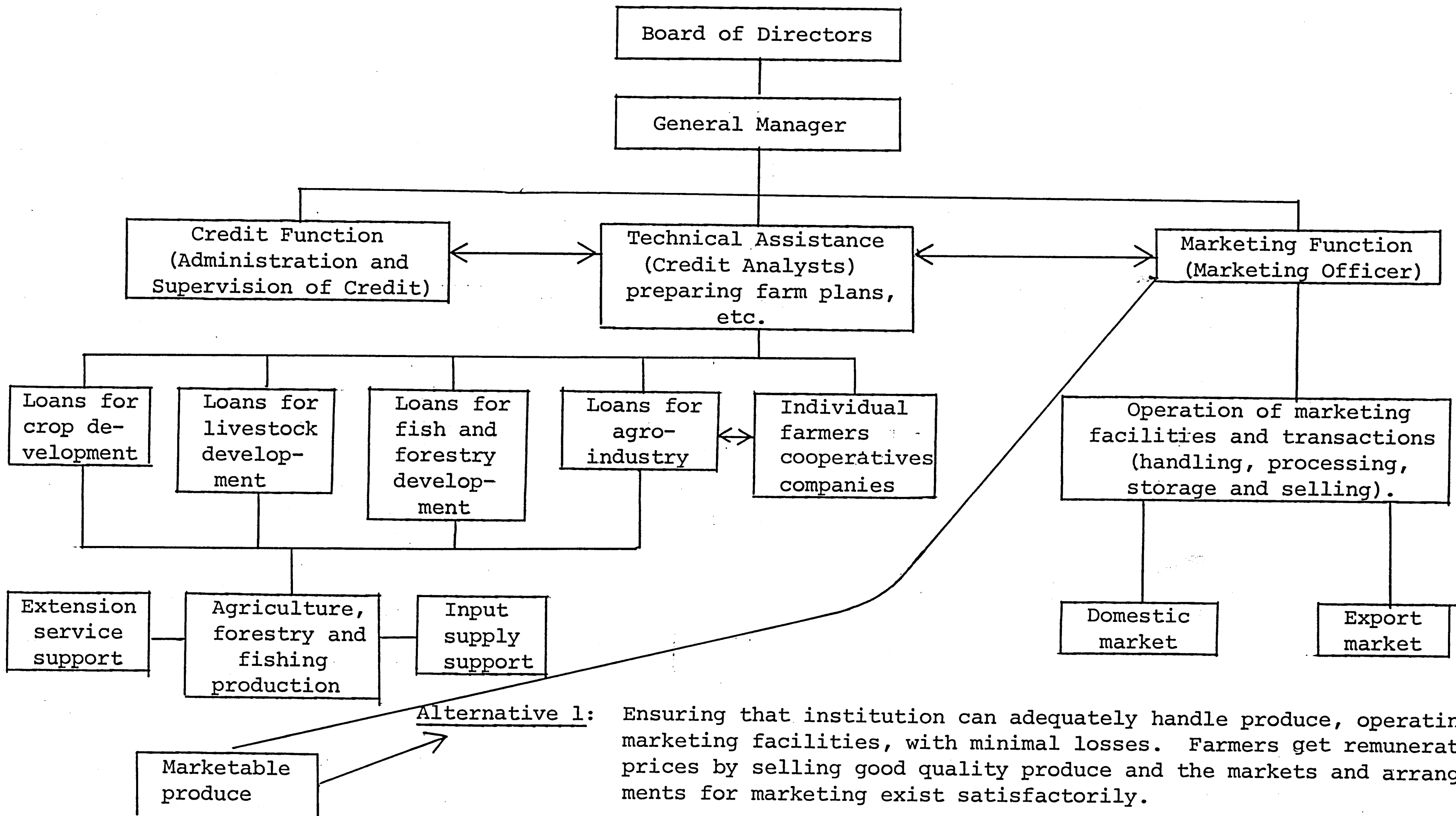
Country	Financial Intermediary Serving Agriculture	Year Established	Principal Aspect of Agricultural Operations
Guyana	Guyana Agricultural Cooperative and Development Bank	1973	To mobilise the necessary funds to stimulate the development of agriculture, fishery, timber and all related industries. Shares are made available only to cooperatives, friendly societies, trade unions, thrift societies, and government or other such bodies. It lends on short, medium and long term basis.
Jamaica	Jamaica Development Bank	1974	Offers two types of loans - one for under J$15,000 and over. The larger loans are for investment in livestock enterprizes, tree crops and agro-industry. These loans are for farms from 16 to 80 hectares but those falling outside this are also eligible. Interest charged is 10% per annum. Loans up to J$15,000 are for small scale farmers for periods of up to 20 years at 4% per annum interest.
	Agricultural Credit Board	-	Government department under a Statutory Board appointed by the Minister of Agriculture, ACB lends directly to farmers as well as the 115 People's Cooperative Banks. Loan purposes cover the entire sphere of farm financing.
Surinam	Agricultural Bank Limited	1972	Extended credit to agricultural, forestry and fishery holdings, including cooperatives.
Trinidad & Tobago	Agricultural Development Bank	1968	Providing short, medium and long term loans to both individual farmers and fishermen and agricultural cooperative societies.
Turks & Caicos Is.	Development Board	1975	On-lending to small scale farmers with particular emphasis on fishing, farming and industrial development.

APPENDIX 2. Some Marketing Organizations Supplying Inputs for Production

Country	Marketing Organization Involved in Aspects to Production
Belize	Cane Farmers' Association provides some short-term credit to members for purchase of inputs.
Dominica	Dominica Banana Growers' Association provides inputs on credit. Dominica Coconut Products Ltd. provides fertilizer.
Grenada	Grenada Banana Cooperative Society and Grenada Cocoa Association provide credit for farm inputs and preparation of land.
Guyana	Guyana Marketing Corporation and Guyana Rice Board supply farm inputs on credit.
Jamaica	Sugar Industry Board, Banana Board and Tobacco Industry Control Authority administer credit programmes.

APPENDIX 3. A Practical Illustration on Integrating Production and Marketing in the Agricultural Sector through Financial Intermediaries.

Proposed Structure of Operation



Alternative 1: Ensuring that institution can adequately handle produce, operating marketing facilities, with minimal losses. Farmers get remunerative prices by selling good quality produce and the markets and arrangements for marketing exist satisfactorily.

Alternative 2: Ensuring proper functioning of marketing enterprises including cooperatives. The markets are well researched to provide the appropriate quality and quantity at profitable prices.

Alternative 3: Ensuring that products can be marketed through an effective and binding contract farming system.