

## MICRO-FINANCE AND FARM FINANCE - IS THERE ANY CONNECTION?

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“Old Paradigm” rural credit, with subsidised interest rates, mainly to individual men, for medium and long terms, with single balloon repayments and no link to savings, has been replaced by “New Paradigm” micro-finance; short term, initially in small sums, sustainable cost-covering interest rates, with frequent regular repayments, mainly to women in groups, with strict savings requirements and relatively high interest rates. Or, has micro-finance not replaced but merely supplemented old-style rural credit?

The answer differs from place to place, but there is no doubt that in some places micro-finance has taken over, as the old development finance institutions have been wound up, have become moribund or have been converted to the new paradigm.

There is no doubt that new style micro-finance has benefited many millions of people, particularly women. They have more assets, they have higher, more diversified and more regular incomes, and they have been substantially ‘empowered’, however that over-used term may be defined or measured. These women have used their small loans mainly to replace more expensive loans from money-lenders, for so-called ‘consumption’ needs such as health care and school fees, and to invest in micro-enterprises, such as vegetable vending, tailoring, snack foods processing, home-based grocery shops, dairy animals, goats, and so on and so on.

So micro-finance has diversified rural livelihoods, in terms both of who controls the assets and of what is done. But, what about the original and still the most important rural livelihood, farming? Is micro-finance a suitable way of financing seasonal crop loans, or longer term farm investments such as tube wells or terracing?

Farming is still mainly controlled by men, who tend not to work in groups as effectively as women. Many farm investments require sums which are well above at least the lower rung amounts of the loan ladders of most MFIs, and incomes from most short and long term on-farm investments are ‘lumpy’ rather than evenly spread. In those respects at any rate, there appears to be a mismatch between micro-finance and on-farm investments.

There is one more fundamental and more measurable feature of any loan, and of any investment, where the source and the use of funds should match. The cost of the funds, that is the interest rate, must be far enough below the expected return from the investment to cover the risk of loss and to allow the owner a reasonable surplus.

Micro-finance interest rates are much higher than the subsidised rates which used to be charged for loans under old paradigm rural credit ‘schemes’, because micro-finance clients need timely and convenient access to credit more than cheap credit; this access costs money. The average return on the

loan portfolio of the MFIs reporting to the Micro-Banking Bulletin was 39.2% in 2002. Micro-finance borrowers can afford to pay these apparently high rates of interest, because they are still lower than the competition, which is the local money-lender, and because the returns on their small investments, petty trading and so on, are very high indeed.

Surveys of 215 such micro-enterprises, in South Asia and Africa, showed that their average annual return on investment was 847%, even after allowing for the opportunity cost of the owners' labour. This apparently astronomic return does not mean that the owners were rich; it just means that the investment amounts were very small indeed, and that the owners' alternative earning opportunities were very un-remunerative.

The above sample of micro-enterprises did not include any farmers, however, because very few people take micro-finance loans for on-the-farm investments. A much smaller sample of 13 small farm activities, in India and West Africa, showed an average annual rate of return of 78% on small farm crop investments, without allowing for risk, or the cost of land, or the capital cost of irrigation facilities. Might this much lower rate of return, less than a tenth of the percentage return earned on non-farm micro-enterprises, in part explain the fact that few farmers borrow from MFIs?

If micro-finance is replacing rather than supplementing traditional rural credit, what can be done to reduce the mismatch between micro-finance and most on-farm investments? Competition between micro-finance providers, including the increasing number of commercial banks which are entering the field, is already increasing efficiency and leading to some modest reductions in interest rates. New technologies, such as micro-drip irrigation and integrated pest management, are reducing both the cost and the risk of on-farm investments. New loan delivery methods, such as informal joint liability groups of four or five borrowers, who are usually men, are reducing transaction costs for both lenders and borrowers.

Nevertheless, the gap is enormous, and it is getting larger. Much remains to be done to make micro-finance as suitable for on-farm activities as it presently is for 'consumption' and for non-farm investments. Otherwise, investment in farming will continue to be reduced, and small farm land will either be left un-used for want of affordable finance or will be taken over by larger scale farmers and corporate plantations. There are already many reasons why people desert the land and migrate to the cities, but it would be unfortunate if the product features of micro-financial services should further encourage people's movement away from agriculture.