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SMALLHOLDER CREDIT IN KENYA AGRICULTURE

By

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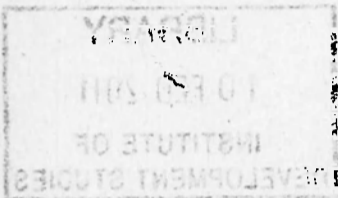
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SMALLHOLDER CREDIT IN KENYA
AGRICULTURE

By

Judith Heyer

Abstract

The provision of subsidised credit for smallholders is widely supported as important means of encouraging smallholder capital formation and production, and as one of the ways of redressing the balance between smallholder agriculture and the rest of the economy. In this paper, Kenya's experience with smallholder credit is reviewed and some of the major issues of relevance to policy in this field are examined.

First, the macroeconomic issues involved in smallholder credit policy are discussed, particularly its relationship to aggregate savings and the productivity of investment at the macro level. The case for providing smallholder credit on fully commercial terms is then reviewed, and the arguments presented in its favour are strong. The case for providing credit at subsidised rates rests on arguments of more limited application in practice, suggesting that the place of subsidised credit might be more modest than had been thought. Finally, some institutional questions are raised and some alternative approaches to those being followed at present in Kenya, are suggested.

SMALLHOLDER CREDIT IN KENYA AGRICULTURE

I. Introduction

There is strong support for smallholder credit programmes both in official circles and among aid agencies involved in Kenya. It is felt that credit would enable smallholders with limited financial resources to undertake farm developments that they would otherwise be unable to undertake; that it would increase the amount of capital used on smallholdings; that it would lead to a faster rate of adoption of farm innovations; and that it would generate increased incomes for smallholders who as a group are at the lower end of the income distribution scale. Smallholder credit is seen as one of the most tangible and obvious ways of encouraging smallholder production. Yet the success so far experienced with smallholder credit in Kenya is limited. There has been disappointment at the rate at which it has been possible to extend credit; there has been disappointment at the poor repayment record; and there has been a suspicion that the credit that has been extended has not led to the marked increases in productivity and output that were expected.

In this paper some of the assumptions underlying the smallholder credit programmes in Kenya are examined against available evidence, and this is used as a basis for recommending a reconsideration of smallholder credit policy. The major issues that are discussed are:

- (i) whether credit is crucial of smallholder development;
- (ii) whether smallholder credit should be provided on commercial terms, on subsidised terms, or both;
- (iii) what institutional arrangements are likely to be most effective in meeting the needs.

The assumption that credit will provide a strong stimulus to smallholder development needs examination. There are two possible explanations of the low rate of capital formation in smallholder agriculture, (if indeed it is so low). It is possible that the

rate of capital formation in smallholder agriculture is low because of the difficulty of financing investments that would be profitable if the finance could be found. Alternatively, it is possible that the rate of capital formation is low because returns to investment are low. The question of returns to smallholder investment is critical to smallholder credit policy. Different policy responses are appropriate depending on whether returns are low or high. For smallholder credit programmes, from the national point of view, it needs to be shown not only that returns to investment in smallholder agriculture are sufficient to cover the accounting cost of providing the funds to finance the investments, but also that the returns are sufficient to justify the use of development funds and other resources for credit programmes rather than for alternative development programmes in smallholder agriculture or elsewhere.

If smallholder credit programmes still deserve priority in the above terms, the next question is whether credit should be provided at commercial rates,¹ subsidised rates, or both. The argument for providing credit at commercial rates is that the resources involved in providing smallholder credit have an opportunity cost to the economy as a whole; that providing credit at ~~commercial~~ rates will ensure that smallholders will only use the credit if the returns they expect more than cover the cost of providing the credit; and that in as much as resources involved in providing credit are scarce, providing it at commercial rates will ensure that the resources go where returns are highest.

The argument for subsidised credit, on the other hand, is the familiar argument that commercial rates do not truly reflect the opportunity cost of providing the credit, and that smallholder estimates of returns are not a true reflection of returns to the economy. This argument, resting on the difference between social and private cost ^{and return} is strong in the case of smallholder credit, and it is examined at some length in this paper.

Finally, there is the question of the appropriate institutional structure for the provision of smallholder credit. At present we have the cooperative marketing societies, controlled by smallholders in small communities, as one of the main foci for short-term credit. We also have the national agricultural credit corporation which is highly centralised and thinly spread through the smallholder areas as the main focus for medium-term credit for smallholders. The commercial banks, which extend short-term credit, up to 3 years, operate their smallholder credit programmes in a similar way to the national credit corporation. Neither the commercial banks nor the national credit corporation is involved in the local communities. They have little access to local knowledge below the district level of individual applicants, local views on the likely success of particular investment propositions, or local sanctions that could be useful in enforcing repayment obligations. The top-heavy bureaucracies that act as substitutes are costly, and experience to date suggests that they are not very effective. The difficulty on the other hand with local participation is that it opens the system to local political influence and corruption. But increased local participation certainly needs to be considered as one of the possible solutions to the administrative problems faced by Kenya's smallholder credit schemes.

The paper starts with a survey of experience with smallholder credit in Kenya. This is followed by a discussion of the macroeconomic relationships that are involved in smallholder credit programmes. The case for providing smallholder credit on commercial terms is then examined, and the case for subsidised credit schemes. In these sections the question of returns to smallholder investment is prominent. These sections are followed by a section in which alternative institutional possibilities are discussed. Finally, the paper ends with a section in which policy recommendations are drawn together. |

II. Smallholder Credit in Kenya

The first official credit for smallholders was given in 1948. It was not until the late 1950s that the commercial banks came in with the provision of short-term credit in Central Province. The informal channels of lending and borrowing in the rural areas are very poorly documented, and although these undoubtedly exist, there has certainly been none of the moneylending tradition in Kenya that is so common and oppressive in many Asian countries. This may be partly attributed to the fact that lending to Africans was not permitted by law in the colonial period. (Loans above Sh.100/- were not permitted by law but the District Commissioner could waive this prohibition in special cases.) The fact that money lending has not developed is more likely to be attributable to the fact that there was little demand for credit in the relatively underdeveloped and recently monetised rural economy. In recent decades there has been a certain amount of lending and borrowing among relatives; there has been some lending and borrowing among clan groups; and there has been some lending by traders in rural markets. It would not be surprising to find a few moneylenders emerging in some of the more advanced smallholder farming areas before long. Most of the lending has been on an informal basis, with no recognised interest charges,² but very little is known about the way in which the different systems operate, the extent of informal lending and borrowing, the mutual obligations involved, and so on. It would be interesting to have more information on the informal credit channels.

The first loans from official sources came from the African Land Utilisation and Settlement Board, later known as the African Land Development Board (ALDEV) which started lending to smallholders in 1948 for "farm development". Between 1948 and 1959 a total of £77,500 was extended to smallholders throughout Kenya through ALDEV.³ The sums involved were small, the majority between Sh.1000/- and Sh.2000/-,⁴ and only a very small number of farmers was reached in this period. The loans were generally for 5 years, with a 1 year moratorium, and equal annual instalments in the remaining 4 years. The interest rate was 4½% in 1948, then 5½% in most of the 1950s, and finally 6½% in the late 1950s. In the early period the loans were for fencing, terracing, manuring, tools and machinery and the payment of labour was included. (Labour is often excluded now, but there has been some discussion about the desirability of

reintroducing it). In the late 1950s the emphasis changed to fertilisers; grade cattle; planting materials for coffee, rice, pineapple and pyrethrum; and a few piped water supplies, tractors and farm buildings. The loans were administered by district agricultural staff in addition to their normal duties, and in some districts the administrative burden on these staff was a serious problem towards the end of the period. The loans were available to 'creditworthy' farmers with 'good investment proposals'. There were also some loans provided by district councils using African Betterment Funds financed through cesses on agricultural produce.⁵

Loans continued to be administered by ALDEV with the help of district agricultural staff until 1963 when the national Agricultural Finance Corporation (AFC) was set up. After 1959, smallholder loans were advanced on a much larger scale, with the help of substantial foreign loans. Between 1959 and 1965, £694,697 was loaned to smallholders.⁶ This included loans from the International Cooperation Administration (ICA) revolving fund from 1959 to 1963, loans from the IERD from 1960, loans from the West German Government from 1963, and loans from the Kenya Government from 1964. The average loan was still between Sh. 1000/- and Sh. 2000/- rising slightly over the period, but the total number of smallholders who received loans grew rapidly. Between 1948 and 1959 the number of smallholders receiving loans averaged a little over 100 per year. Between 1959 and 1965 the average rose to well over 1000 per year.⁷

The 1966-70 Development Plan included an ambitious programme smallholder credit which was intended to rise to £4.3 million for the plan period, reaching 3 per cent of the smallholders outside the settlement schemes and the pastoral areas (for much of which separate credit arrangements were made although non-Masai pastoral areas are not at present catered for at all.) In the event the programme was scaled down. The current Development Plan 1970-74 includes a more realistic programme. In the current plan, the AFC has been allocated £1.9 million for smallholder credit, and £425,000 has been allocated for short-term loans through the Cooperative Bank. The AFC is expected to provide a further £1.5 million from

its own resources in addition to £300,000 which is revolving. The finance comes from different sources: the IDA which has a project in 15 districts in which land registration has enabled land to be used as security for loans (£1.1 million 1970-74); the West German Kreditanstalt für Wiederaufbau Kisii/Kericho project which started before land titles were available in those two districts but which now also uses land as security (£112,000 1970-74); 'other new loan programmes' (£0.7 million); and the AFC's own funds which are to be used among other things where no land titles are available. The IDA and West German credit programmes are for a wide range of farm developments, but in practice they tend to favour dairy cattle investments. The loans are for 2 - 7 years, and the majority are between Sh. 1500/- and Sh. 10,000. The IDA programme is supposed to be accompanied by a 30% increase in extension and loan administration staff provided by the Kenya Government. The West German programme includes intensive supervision as part of the aid agreement.

A small amount of short-term credit is available to smallholders for wheat and maize as part of the Guaranteed Minimum Return (GMR) scheme. Smallholders are eligible under this scheme (which was designed for large farms), for which the minimum acreage is 15 (6 hectares). Relatively few smallholders have applied for these loans, as the minimum acreage is high. In 1968 and 1969 smallholders were allowed to apply in groups but this is no longer allowed.

Short-term credit is also being extended through the cooperative movement.⁸ Initially this is coming from the cooperative movement's funds and from £425,000 allocated to the Cooperative Bank by the Government for this purpose. The intention is to expand the scheme if it is successful. A substantial amount of credit was outstanding at the end of 1968 in the cooperative movement. According to the 1970-74 Development Plan "At the end of 1968 it was estimated that about K£1.3 million was owed to societies by their members. Much of this had been outstanding for a long period and

many of the loans had been issued without specific conditions concerning repayment periods and interest rates, etc., being specified."⁹ The new scheme is being tightly administered. Only societies that qualify can participate. The qualification is that they be well managed and this is judged by whether their accounts have been audited up to date for the past three years, whether they are recommended by a Cooperative Officer, and (where relevant) whether their Union qualifies. Societies that qualify for the loans scheme lend to members and are responsible for collecting repayments and repaying the loan. In 1972, there were 9 unions that were qualified and participating, and 83 societies of the 104 affiliated with the qualified unions were participating. Most of these were primarily engaged in marketing coffee. In three years 1970 - 1972, nearly £500,000 was extended by the Cooperative Bank under this scheme and more must have been extended from Cooperative society and cooperative union resources.¹⁰

In addition to the AFC and the cooperatives, the other official organisations extending credit to smallholders are the Kenya Tea Development Authority (KTDA), the Pyrethrum Board, the Cotton Lint and Seed Marketing Board, and the Settlement Fund Trustees which are outside the scope of this paper. Settlement schemes have been treated very differently as far as credit is concerned and a discussion of the issues involved would require a separate paper.

The KTDA lends for fertilisers and it used to lend also for planting material, but when vegetative propagation replaced the previous system of establishing new tea the planting material loans were discontinued. Fertiliser loans are available for tea at least 4 years old and are repayable in 1 year. Started in the early 1960s, these loans were given for 51% of the possible total acreage in 1968/69 and again in 1969/70. They are repaid over one year through 20% deductions on net payments for green leaf. The loans that used to be given for planting material were much longer: they were repaid over about 15 years through deductions on the delivery of leaf.¹¹

The Pyrethrum Board supplies pyrethrum plants and fertilisers to Cooperative societies on credit repayable in six instalments from months 7 - 12 after planting. It charges no interest on this

credit. The materials supplied on credit have been sufficient for 1000 acres (400 hectares) in 1970/71 and 1971/72, about 2% of the total acreage.¹²

The Cotton Lint and Seed Marketing Board gave loans in the early 1960s, and since 1967/68 these have been provided through the AFC. Substantial sums have been involved but recovery records have been very poor. Loans to cooperatives and small growers were recorded as £111,583 in 1968/69, and £160,661 in 1969/70, but no separate figure for small growers was available.¹³

The commercial banks lend to smallholders short-term, the median period being about 18 months and the longest about 3 years. At the end of 1965 it was estimated that about £400,000 was outstanding to 3,400 smallholders, about 90 per cent in Central Province.¹⁴ Since then there has been more lending in other areas as well as in Central Province, according to one source the number of loans in Myeri and Kisii is far larger than from official sources.¹⁵ Commercial bank rates are higher than those charged by the other lending agencies; they usually insist on mortgages, although in Kisii they were lending quite extensively before land registration had occurred;¹⁶ farmers fear the harshness with which commercial banks enforce repayment.¹⁷ The commercial banks usually insist on some previous connection with the bank either in the form of a savings account or a current account, and they prefer to lend to people with regular sources of non-farm income.

Very little is known about trader credit, or credit from relatives, clan groups, and friends. Casual evidence suggests that it quite extensive but that few accepted norms have yet developed with respect to terms. Until recently, most of the official credit available to smallholders was medium-term: 3-7 years. The exceptions were the KTDA tea fertiliser loans, cotton loans, pyrethrum loans, and the loans for wheat and maize under the GMR system. At the end of the 1960s there was a change of policy, and short-term credit is now getting more emphasis through the new cooperative credit scheme which started in 1970. If one includes the commercial bank credit, short-term credit may have been as important as medium-term for

some time and the cooperative credit scheme may simply be giving it a firm ascendance over medium-term credit.¹⁸

The purposes for which credit is available are limited. The IDA loan, which is the main source of medium term credit in 15 districts in which land has been registered, has been very predominantly for grade cattle and related investments. In 1970/71, 83 per cent of the total value of the IDA loans to smallholders was for grade cattle purchases (51%), dairy equipment, fencing, clearing and establishing pasture, and water development, all of which may be assumed to be associated with dairy cattle enterprises. Only 13 per cent was for crop development, and farm mechanisation, for example, was responsible for such a small amount of the total that it gets no mention.¹⁹ These loans are supplemented by the tea fertiliser loans, cotton loans, pyrethrum planting loans, and wheat and maize loans under the AMR scheme. The newly started cooperative credit scheme will provide loans primarily for coffee producers, in its initial stages at least, but the loans will not be confined to the development of coffee. Loans are available for limited range of enterprises, and as long as the current arrangements continue it will be difficult for smallholders to get loans for the development of food crops, for the establishment of tea, for horticultural products, and for many other specific purposes. The exclusion of labour from many of the credit schemes is another restriction that has serious implications at the smallholder level and beyond.

The interest charged on smallholder credit varies. In recent years it has been 7½% on loans from the AFC, but it is a condition of the IDA loan phase II that it be raised to 8%. The cooperative credit scheme allows some flexibility in the rates charged by societies but recently the rate has been 10% in many societies. Commercial banks have been charging 9%. There is little question that these rates are subsidised. Smallholder credit is probably cheaper than the opportunity cost of the funds,²⁰ making no allowance for the heavy costs of administering the credit. Even the commercial banks appear to be operating smallholder credit

schemes that are at best marginally worth while, depending on the way in which one values the funds. The subsidisation of smallholder credit raises important issues that are discussed in a later section.

The selection criteria are important as the means by which available supplies of funds are rationed among a large number of applicants. The criteria in use at the moment appear to be some notion of creditworthiness, some notion as to the viability of the investment, and some ability to provide security. Loans are more likely to be given to people with regular off-farm incomes; they are more likely to be given to people with established reputations as good farmers and as men of integrity; they are more likely to be given to people who have ample resources to carry investments through. The criteria clearly favour the farmers who are relatively well off, the farmers who only farm part-time, the farmers who have adequate resources already. The criteria suggest a pre-occupation with the ability to repay rather than whether or not the farmer really needs the credit. This may make sense for a commercial scheme, but it is hardly consistent with the appropriate goals of an official subsidised credit programme.

In spite of these criteria, the repayment record is poor. The situation has deteriorated in the 1960s as smallholder credit programmes have been expanded. In 1966, 70 per cent of the total number of loans were overdue (representing 43 per cent of the total amount). Of these, 47 per cent (representing 22 per cent of the total amount), had been overdue for more than a year. The smaller loans were clearly more heavily in arrears. According to the 1970-74 Development Plan smallholder loans are still 50 per cent in arrears which suggests little improvement. In 1966, the record was good in some districts, and very poor in others. In Kericho district only 4% was overdue for more than a year, and in Busia only 3%. In Kilifi, at the other extreme, 52% of the total amount was overdue for more than a year in 1966, and in Kitui 50%.

In part this is obviously an administrative problem. It does not necessarily signify failure on the farms concerned. It may be that repayments have not been sufficiently strongly solicited. But even if the problem is administrative, it has serious implications.

It limits the extent to which the funds can revolve and be used to finance new investments on new farms. It also limits our ability to attract more funds for smallholder credit in future.

The administration of smallholder credit in Kenya varies. The AFC operates through district branches and sub-branches but only about 1 in 3 districts in Kenya have these. The branches and sub-branches are manned by about 120 field staff altogether,²¹ each branch or sub-branch averaging about 7-8 staff. The branches serve the large farms as well as the small, the bulk of the business still relating to large farms. For the smallholder loans, most of the time of the AFC officers is taken up with the filling of the individual applications for credit, and the processing of these applications. AFC staff visit farms to help fill in ^{of} applications ~~part~~ which are also filled in by agricultural staff, and these visits take quite a lot of time. Once the loan has been granted, there is little further contact with AFC staff, however. Farms may be visited if the repayments are seriously overdue, in which case the farmer is charged 35/- for the visit.²² Government agricultural staff also help to fill in application forms and have to support the loan applications. The agricultural staff have other responsibilities, and they often find that loans work takes up a disproportionate amount of their time. It can be argued that it is undesirable to involve agricultural extension staff in the administration of loans as this destroys their advisory relationship with their clients. There is no doubt that AFC loan administration is weak in smallholder areas. An important question is whether the cost of providing a more adequate service would be justified.

The commercial banks are in a similar position to the AFC but they do not have the support of the agricultural extension staff to which the AFC is entitled. The Standard Bank employ a field officer at every major branch and he goes out to small farms to fill the loan application forms much as the staff of the AFC, and he does not normally have time to visit loan recipients after this. The Kenya Commercial Bank and Barclays do not even do this. They interview applicants at the bank branch and only visit the farm if the loan applied for is large.²³

The West German credit scheme in Kericho and Kisii is more heavily supervised, and includes a substantial amount of farm advisory work. It would be interesting to get an evaluation of this to see whether the additional cost of providing the advisory service could be justified on a larger scale.

Cooperative credit is being given on quite a different basis, of course. In the cooperative credit scheme the only direct supervision is informal by fellow cooperative society members who have an interest in interest in ensuring the repayment of the loan.

The strength of the administrative machinery is important not only in relation to the recovery of the loans but also from a development point of view. If loans are coupled with good advice, and if they are refused in the right situations, they can provide an incentive to farmers, and they can encourage the adoption of new methods and new farm systems with increased income, output and employment opportunities. One is then looking to the administrative machinery to do more than provide the loans: it is also being used to supplement the extension service. This additional contribution should be recognised.

From the point of view of repayment, it is not only the administrative machinery, but also the enforcement sanctions that count. The existence of ultimate sanctions that can be applied in cases of default makes a great deal of difference to the loan repayment position whatever the administrative machinery. In the mid-1960s the ultimate sanctions were weak. Land titles were used as securities, but the credit agencies were not prepared to foreclose on the land. Similarly, they were reluctant to take defaulters to court to get salaries or movable assets attached. Recently, there has been some improvement. Land has been seized and sold, in a few cases, and this has provided a warning to potential defaulters who know

that threats that they may lose their land are real. Defaulters have been taken to court and had their salaries and movable assets attached. There is an obvious reluctance to use the ultimate sanctions: it is expensive, troublesome and can earn the agency concerned a good deal of bad will, but the existence of a few example cases is sufficient to deter a large number of potential defaulters who now know that they can lose their land or other assets. This was not the case in the early and middle 1960s.

This brief survey of Kenya's smallholder credit programmes would not be complete without a mention of the experiments with smallholder credit that are taking place as part of the Special Rural Development Programme (SRDP). In addition to the regular credit schemes, there are three different types of smallholder credit scheme being tried out as part of the SRDP. These schemes represent attempts to overcome one or more of the problems of the regular schemes: the fact that credit is not available for all agricultural production purposes; the fact that credit is only available to limited groups of farmers; the fact that it is inadequately associated with crucial inputs, particularly extension and farmer education; and the fact that it is running into administrative bottlenecks all the time. The different experiments are summarised below.

a) The Vihiga Maize/Credit Package: this experimental project was designed to overcome the difficulties of smallholders with very limited acreages of maize in getting access to seasonal credit.²⁴ It was hoped that it would contribute towards a solution to the provision of seasonal credit for small maize producers throughout the country. Small numbers of farmers were selected according to 'credit-worth', maize acreage (between 2 and 4 acres), and ability and willingness to follow recommended practices. They were given an authority to incur expenditure which they could present to a registered input stockist in return for the

hybrid seed, fertiliser and insecticide required for 1 acre of maize. Stockists were paid (after many months) by the AFC. Smallholders repaid the AFC through agricultural staff after the maize was harvested. Each loan recipient received intensive supervision by agricultural staff during the growing season, and agricultural staff were also involved in collecting loan repayments at the end of the season. The repayment record was disappointing: only 75 per cent of the small number of recipients in the 1st year repaid their loans. There was some evidence to suggest that farmers were not enthusiastic about the loans; several did not use loans to which they were entitled; several did not re-apply the following year; the stockists were not happy with their role in the scheme either. Nevertheless it was decided that the scheme should be continued and expanded. Starting with 60-70 farmers in the first year, increasing to about 370 in the second year, there were problems with increasing the numbers. The major problem was the intensive supervision which was thought to be crucial to the success of the scheme. Some discussions about the possibility of using group extension methods to solve the problem were underway. The Vihiga experience underlines the importance of the additional staff resources required both for extension and for collection of repayments, and there is no reason to assume that the scheme as originally conceived can overcome these. The Vihiga scheme is facing very similar problems to the problems faced by the AFC over smallholder loans in general, and the loans in the Vihiga scheme are for much smaller amounts so the extra staff inputs required are even more difficult to justify in the Vihiga case.

b) Tetu Credit for Hybrid Maize Inputs: In Tetu farmers attending a specialised Farmers Training Centre (FTC) course in maize-growing are given credit in kind for $\frac{1}{2}$ acre of hybrid maize inputs.²⁵ The Tetu scheme differs from the Vihiga scheme in that farmers are selected according to whether their performance is poor enough

to suggest that they need to learn about maize growing. The FTC course is a key input, but there is also an extension staff are supposed to supervise the growing input: of the crop quite intensively. In the early stages of the experiment it was pointed out that extension staff would not have enough time to supervise the farmers individually, so the farmers grouped themselves together so that the extension staff could visit them in groups, making the extension task manageable. The loan repayments are the responsibility of the chiefs. It remains to be seen whether the collection of loan repayments has been successful. There may also be problems in expanding the scheme as far as intensive supervision is concerned, although this may not be so crucial if the FTC course continues to be an integral part of the scheme.

c) Mbere and Migori Stockists' Credit: in Mbere and Migori credit experiments the input stockists are given credit and it is hoped that this will lead to the provision of credit to smallholders as well.²⁶ So far this hope has not materialised and as there is no particular incentive to stockists to pass the credit on to smallholders it may never materialise at all. There is obviously some value in providing stockists with credit to enable them to carry adequate stocks of inputs among other things and it is perhaps wrong to think of these schemes as schemes involving smallholder credit.

In none of these schemes have the supervision problems yet been solved. Both supervision and loan collection become difficult once the scale of operation increases above the very small numbers of smallholders involved in the initial stages of the experiments. The experiments were not designed primarily as experiments in the provision of credit, still less as experiments in the administration of credit on a large scale. Nevertheless the opportunity to experiment with different administrative arrangements that is offered as part of

the SRDP could be very valuable, and it would be worth trying out more schemes that might have a possibility of succeeding on a large scale.

Having surveyed Kenya's experience with smallholder credit, we now turn to the major issues mentioned at the beginning of the paper.

III. The Macro-Economic Setting

Smallholder credit is related to some of the macro-economic variables that are crucial to the development of the economy as a whole. Smallholder credit programmes may have important implications for savings and investment in particular. There is a substantial amount of evidence suggesting that considerable savings are being generated in Kenya's rural areas at present. The availability of funds for the purchase of former European farms in the early 1960s; the phenomenal collections for harambee projects; the extent of investment in trade, transport and other non-agricultural businesses in the rural areas; the growing amount of investment in urban property; the experience of the post office, commercial banks and cooperative societies receiving rural savings deposits; all suggest that there are large surpluses being generated in the rural areas, even in areas that are quite poor.²⁷ It is not difficult to find the source of these surpluses, the boom in coffee production, the boom in other types of smallholder production, the rising farm incomes throughout the rural areas. But it is more surprising to note that a great deal of the rising income is being saved rather than consumed, that a great deal is going into non-agricultural uses, and that in some of these uses the funds earn relatively low returns. The interest on savings account with a commercial bank or post office is only 3% per annum. The interest that is being offered as part of the Cooperative Thrift Scheme is only 4%.²⁸

The amount of investment that is taking place on small farms should not be underestimated. It is clear that a great deal of capital formation is being undertaken on smallholdings, and that the statistics underestimate this. The investments in permanent crops, land improvements, livestock, fencing, water supplies, ^{and} buildings all add up to a substantial amount. But it is still true that the capital involved in smallholder agriculture in Kenya is low compared with that involved in other activities in the economy, and that it is also low compared with that involved in smallholder agriculture in some other parts of the developing world.²⁹

If the overall picture is one of excess savings coexisting with low rates of investment in smallholdings, there are several questions that arise. Why do the excess savings not get channelled into investments in smallholdings? Why are pressures not built up to channel the excess savings into smallholder agriculture? Why have informal commercial or other means of channelling the excess savings into agriculture not developed? Is there any point in encouraging the development of appropriate institutions? Is there a need for additional encouragement at the margin because agriculture is not quite competitive enough, or innovations are too risky from the smallholders' point of view? Is there a more fundamental reason why the excess savings are not available for agricultural investment? And is there any reason to channel more of these savings into agricultural investment?

This leads into some serious questions for the national economy: (1) do we want to mobilise the excess savings in the rural areas and if so what would the implications of doing so be? (2) does it matter if the savings are used to make investments outside agriculture? (3) is there still a case for channelling these or other savings back into agricultural investments?

The question of whether or not we should mobilise the excess savings is not as straightforward as it might sound. The savings represent a decision not to use resources: they free resources for use elsewhere. The resources that are freed are available for use elsewhere whether the savings that freed them are channelled into the financial institutions or not. If these savings are put into savings accounts in the banking system the banking system is likely to use them as a basis for a multiple expansion of credit. If the savings are kept under floors or beds instead, there are other ways of creating an expansion of credit if this is desirable, but the expansion is no longer so automatic. It can still be done on the basis of the fact that savings are known to be stored under floors or beds, but it requires deliberate intervention by the monetary authorities to create the expansion of credit. In fact, it is possible that this expansion of credit would not be desirable and that a sudden injection into the banking system of savings that have hitherto been kept under floors would lead to an excess expansion of credit, one that could not be matched by the resources available. In this case positive intervention by the monetary authorities to prevent the excess expansion of credit would be called for. There is thus no particular merit in channelling these savings into the banking system rather than leaving them under the floor as far as the monetary variables are concerned. However, there may be some merit from other points of view. The fact that returns can be earned on smallholder savings may lead to an increase in smallholder incomes; it may also encourage smallholders to save rather than use more of their surpluses. It is certainly important to consider the influences both on the monetary situation, and on the generation of savings in rural areas.

The second question is whether these savings should be channelled into smallholder agriculture or into other activities in the economy. The only merits of channelling

these particular savings into smallholder agriculture are (a) that it may be cheaper and easier to keep the funds circulating within the rural areas rather than allowing them to flow out and then back again; and (b) that it may act as an encouragement to further savings if smallholders know that their savings are directly benefitting their own local community.

The question of whether these savings (or indeed any other savings) should be channelled into smallholder agriculture at all is a more difficult one. The immediate answer is that the savings should be used to finance investments on which the marginal social return is highest. They should only go to smallholder agriculture if it is felt that the return there would be high. The fact that there is said to be a strong demand for credit among smallholders does not necessarily mean that the return on investments that it might finance are high. In the first place, the demand voiced so often by politicians and farmers may not be a serious demand that would be followed up if the funds were made available. In the second place, it may only be a demand for subsidised or free credit, a demand that does not necessarily imply a high return on investments so financed.

As mentioned at the beginning of the paper, the market may not provide a good measure at all of the relevant costs and returns. Smallholders are likely to underestimate the returns to their potential investments, and the commercial rates at which credit might be provided may well not reflect the opportunity cost to the economy of the resources involved. But unless the social evaluation of returns is high enough to justify using these scarce development resources for smallholder credit rather than anything else, there is no reason why the savings should go into smallholder agriculture. It is not by any means obvious from the evidence available that social returns to investments in smallholder agriculture are high enough to justify efforts to increase the flow of credit

into that sector. This is something that needs further investigation, and it is a point to which we return in the next sections.

Thus, as far as the macro-economic variables are concerned, it is important to bear in mind both the influence of smallholder credit programmes on the generation of savings, and the influence of the programmes on the productivity of investment in the economy as a whole. There is a possibility that a smallholder credit programme might divert funds from more profitable to less profitable uses in the economy and this possibility should not be ignored. Smallholder credit programmes are also likely to influence the savings rate. If smallholders do not have access to credit this might raise the savings rate as they deny themselves consumer goods to release funds for investments. If savings earn higher returns financial institutions this might also encourage more savings.

IV. The Market for Credit on Commercial Terms

There is a strong bias against providing credit to smallholders on commercial terms based on the assumption that it is against the interests of smallholders to do so, and that it is not in the national interest to do so either. In this section, it is argued that it is not against the interests of smallholders to provide credit to them on commercial terms - some smallholders stand to gain from such provision; and that the provision of smallholder credit on commercial terms does not conflict with national development - rather it can contribute towards it.

If financial resources are scarce, there is a strong case for providing them on terms that reflect their opportunity cost. If this is done, the financial resources will be used where the returns are greater than the cost, and where returns to their use are highest, ignoring for the moment possible differences between private and social returns. If credit is provided at less than cost, there is a danger that it will be put to uses in which the

returns does not justify its use; that it will be difficult for lenders to get funds for credit; that alternative sources of finance will not be exploited to the full; and that in the process of rationing available supplies some potential users with investment proposals involving high returns will be denied access to the funds. It is these potential users denied access to funds through the present rationing process that stand to gain from the provision of credit on commercial terms. Smallholders who have good investment propositions but do not meet the accepted criteria for selection, would benefit from access to funds at present denied them even if the cost of these funds were high. Their access might well represent a gain to the national economy in that their highly productive investments would no longer be ruled out.

The other advantages of providing smallholder credit on terms that reflect its opportunity cost are also worth considering a little more fully. If smallholder credit is offered on opportunity cost terms, it should become easier to attract funds into the provision of such credit: more would be available for this purpose. Although this may not seem very important in Kenya at present because ample funds seem to be forthcoming from the international aid agencies for smallholder credit, it does open up the possibility of using funds from commercial sources for the provision of smallholder credit. Savings may be encouraged if this enables commercial institutions to offer more attractive returns on savings deposits, although it is unlikely that this effect would be significant in practice. Smallholders would also be encouraged to make fuller use of alternative sources of finance, some of which may be cheaper from a national point of view, their social cost being less. For example, smallholders may be encouraged to finance more of their investments through their own abstentions from consumption thus raising the savings rate marginally.

Providing credit on terms that reflect its opportunity cost eliminates some of the costly process of rationing. It is no longer necessary to apply such careful selection criteria or to scrutinise such large numbers of applications. This can represent a real saving which is quite significant, although in some parts of Kenya there are not even large numbers of applications for subsidised credit.

Finally, the provision of credit at opportunity cost excludes its use for low return investments that are no longer worth while if the full opportunity cost of credit is taken into account.

The provision of credit on opportunity cost terms is not necessarily the same as the provision of credit at commercial rates. Commercial rates may not adequately reflect social opportunity costs for a number of reasons. But they are likely to be closer to social opportunity cost rates than the other rates currently in use, and they may not be a bad approximation in practice.

At present there is very little credit provided to smallholders at fully commercial rates, the exception being credit provided informally by rural traders and others. In some such cases it appears that the arrangements are such as to involve full commercial terms.³⁰ The commercial banks, for example, only provide smallholder credit under pressure, and they do not charge commercial rates. The rates they charge, 9% on loans up to 3 years, almost certainly fall short of covering the administrative costs as well as the cost of the funds. The cost of the funds is of course difficult to define, but by most definitions 9% is very low leaving out any costs of administration. The other major sources of credit, the official smallholder credit schemes, are subsidised as a matter of policy.

There may be inadequate opportunities for smallholders to borrow at commercial rates. The cost of supplying credit to smallholders is undoubtedly high: the administrative costs are high, the rate of default is high, and the cost of funds is high in Kenya at present. But if there really is a strong demand for credit, the cost would not be a deterrent to everyone. Many smallholders who are able to get returns substantially above the cost of the credit would demand it at commercial rates if they could not get it elsewhere. The large numbers of applications for subsidised credit, suggest that many smallholders are not able to get credit elsewhere, and among these there may be substantial numbers who would be prepared to pay for more expensive credit that was available to anyone. There may well be room for the provision of credit on commercial terms, in addition to the subsidised credit already available.

It has been suggested that there are problems on both sides of the commercial credit market in Kenya at present. Commercial institutions are inexperienced in evaluating smallholder credit applications, they have not been sufficiently imaginative in devising new methods of securing loans, and they have not felt able to charge the very high interest rates that are associated with a properly administered smallholder credit scheme that justifies itself commercially. A guess is that the appropriate interest rate would be between 20 and 30 per cent per annum.

Smallholders in turn are inexperienced in the use of credit, and they do not have enough good investment opportunities justifying its use. There is certainly a problem of education in relation to credit for smallholders. This credit is often given to people with very little experience of financial dealings. There is little attempt to explain the procedures, the terms and the obligations involved, and smallholders are often genuinely bewildered by the demands that are made when repayment falls due,

and the restrictions on the use of the credit they are given. There is a need for more careful explanation and education in the use of credit, even though this raises the cost of its provision.

The more fundamental question, however, is whether smallholder investments can bring the returns that make the credit worth while, both individually and from the national point of view. With the present state of technology, the skills and other resources of smallholders, and the level of provision of infrastructure and services, it may not often be possible to get a return that justifies the investments. To get a high return on smallholder investments the technology has to be adequate and within reach of the smallholder; the smallholder has to have the skill and other resources required to carry out the investment at a satisfactory level; the markets, the inputs and the other services also have to be available at an adequate level. It is often not sufficiently strongly understood that successful investment depends on all of these things. It often requires new skills that take time to acquire. It often requires technological solutions that are not available. It often puts a strain on resources like farm labour and land, and on the infrastructure and other farm production services. In Kenya, at present, there are some areas and some smallholdings on which conditions for successful investments are favourable. But there are many areas and many smallholdings for which too many of the basic requirements are missing. An example of a high return investment that has attracted a great deal of credit in many areas of the country is grade cattle, as we saw earlier. The technology has been developed, the inputs are available, the markets are good, the veterinary services are adequate, the skills and resources required are available on many smallholdings, and on many smallholdings it has been possible to get very high returns to investments in grade cattle. This does not, however, mean that all smallholders

in the appropriate areas can get very high returns. There are many smallholdings on which the necessary skills and other resources are insufficient and on these holdings grade cattle investments fail. There are some areas where conditions are less favourable than others. In many areas more extension advice, more training in cattle management, more services, and better access to markets are required before more than a small minority can get high returns to investments in grade cattle. The success of the investment depends critically on the whole range of factors mentioned, many of which are beyond the control of the smallholders concerned.

An example of a much less successful investment is cotton. Cotton does not often give high enough returns on smallholdings in Kenya to justify the use of credit on commercial terms. The technology is deficient, the infrastructure and services in many cotton-growing areas are weak, and the farm resources are inadequate. What is needed is more research to produce higher yielding varieties of cotton; more agronomic research; more farm skills in the production of cotton; the availability of inputs at the right time; and so on. Until all of these aspects of cotton growing are improved, it is difficult to justify the use of credit to finance its production. The cotton example underlines the need for a package approach and raises the more general question of whether it is credit or other smallholder development programmes that are really required.

In summary, if there really is a strong demand, credit on commercial terms should be encouraged. To concentrate entirely on subsidised credit introduces elements of selection that are almost certain to exclude some smallholders who could benefit from credit on commercial terms because they have sufficiently good investment opportunities to justify the high-cost credit and they cannot get access to the limited supplies of

subsidised credit. The encouragement of the provision of credit on commercial terms would also encourage the supply of funds to smallholder agriculture, where the returns to investments were demonstrably high. It might also help to divert some of the excess demand for subsidised credit to which everyone has to turn in the absence of the commercial alternative. The method by which one might encourage the provision of credit on strictly commercial terms is discussed further after a discussion of subsidised credit.

V. Subsidised Credit

The case for providing credit on subsidised terms is more generally accepted. It rests on the difference between private and social evaluations of expected costs and returns. It is also said to rest on such arguments as that one might want to favour smallholder investment for income distribution reasons, or that one might want to encourage more capital formation in smallholder agriculture for output reasons.

It is very likely that smallholder perceptions of the value of investments will differ substantially from social evaluations of the relevant costs and returns. Smallholders are likely to perceive risk differently, for example, the smallholder's subjective evaluation of the risk attached to an investment usually being very much higher than any objective measure of risk. Smallholders who have been told by extension officials or others that inputs will arrive on time this year, that markets will be found for them, that the product will respond to recommended treatments in a predictable way, have to take a lot on trust. They may justifiably perceive of the risks attached to the innovation being much higher than they really are. They may also rate the costs of failure higher than society would. These smallholder views of risk and its consequences that are inflated from society's point of view may justify a

subsidy for credit to encourage smallholders to undertake investments that are only marginally worth while according to their perceptions but very worth while from a social point of view. But other ways (such as insurance or guarantees) of encouraging the investments may be more effective.

Similar arguments apply to 'education' factors involved in innovations. Smallholders may be reluctant to take up innovations they do not know, and until they have experience of the innovations they may remain unconvinced. But once they have experience the innovations will be attractive. The purpose of subsidising the credit to finance the innovative investments would be to enable them to gain the experience to convince themselves that the investments were worth while. Whether subsidised credit is the best way of encouraging such innovations is a debatable point.

There are other social versus private considerations that could justify the subsidisation of credit, making a socially justified investment attractive from an individual smallholder's point of view. These considerations include externalities; the fact that a few have to be induced to innovate before many will adopt; the fact that there are difficulties for the first innovators over input supplies, market outlets, etc. These might all be used as arguments in favour of supplying subsidised credit in particular circumstances.

The other set of arguments in favour of subsidised credit is quite different and relates to the underprivileged position of smallholder agriculture in production or income terms. For income distribution reasons or because smallholder agriculture does not get sufficient encouragement to make its rightful contribution to national output, one might argue in favour of subsidised credit. Such arguments are indeed frequently put forward. These arguments have to be considered in relation to the alternative methods

of promoting a more equitable income distribution or of promoting smallholder production. If one wants to increase the incomes of smallholders, or to increase output or even capital formation on smallholdings, one has a variety of alternative ways of achieving this. Only one of the possibilities is subsidised credit, and it may not be the most effective way of achieving the aim. Alternatives include the raising of agricultural product prices, the subsidising of agricultural inputs, the provision of more research, extension, education and other services to smallholders, the improvement of marketing channels, the improvement of infrastructure, and so on. One has to consider seriously whether the same funds used in one of these other ways would bring greater increases in incomes or output than subsidised credit. There is much to suggest that subsidised credit is a relatively inefficient alternative out of all those possible. More direct programmes influencing larger numbers of smallholders are likely to be more efficient.

The decision as to whether to put funds into subsidising credit rather than one of these other alternatives rests on whether credit is a real bottleneck to smallholder development or whether other parts of the package, are more important. Is it mainly, or even significantly, lack of credit that is holding smallholders back? Or would they benefit more from a similar expenditure on such things as effective extension advice, research, marketing facilities, or education? One usually has this choice.³¹ Funds and other resources not used to subsidise credit can usually be put into these sorts of alternatives.

There is some evidence that in many cases it is not the lack of credit but the lack of other elements that is holding smallholders back. Once the other elements are provided, smallholders can usually find funds to finance associated investment expenditures. Evidence from Vihiga suggests that both those with and those without

credit adopted the hybrid maize package once the information and input supplies were made accessible. Evidence from the FAO fertiliser demonstration programme suggests that once farmers accept the value of fertilisers they do not need credit and indeed they often reject credit to finance its use. Smallholder coffee production was developed with very little access to credit. There is evidence from many parts of Kenya of the successful and widespread adoption of new practices, some of which involve substantial investment expenditures, without the provision of credit, and there is evidence already quoted of plentiful supplies of rural savings. It is certainly possible that the more important requirements are the technical information, the extension advice, the farmer education, the availability of inputs, and other elements making for high returns to investments mentioned above. It may well be that alternative measures to aid smallholders would represent more effective uses of scarce development resources than programmes of subsidised credit.

If the case for subsidising credit for income distribution reasons or to counter the existing bias against smallholder production is not strong, the case for subsidising credit on the grounds that social costs and returns differ substantially from private costs and returns still stands. It is for this reason, rather than for income distribution or resource allocation reasons that one might consider the provision of subsidised credit, although as mentioned even in these cases there may be more efficient ways of achieving the desired result.

The reasons for providing subsidised credit have an important bearing on the selection criteria that should be used. Once subsidies enter into the provision of credit, one is no longer using the market to ration available supplies, and alternative rationing procedures have to be devised. Many people want subsidised credit in preference to other credit because it is cheaper. Many of those who normally finance their expenditures from alternative sources

prefer to get subsidised credit if they can. In addition, many whose investment opportunities could not justify credit on commercial terms join the queue for subsidised credit which makes the relatively low return investments attractive. There are large numbers of smallholders who think they 'need' credit if it is offered on subsidised terms. A subsidised credit opportunity discourages other sources of credit from being used to the full, and it can create difficulties in selecting from large numbers of applicants who would like their credit cheap.

The selection criteria used to ration the available supplies of credit should be devised to ensure as far as possible that the subsidised credit goes to those for whom it was intended. If the credit is to encourage those whose private evaluations of costs and returns make a socially worth while investment only marginally attractive, care should be taken to devise selection criteria that will distinguish those cases. Some attempt might be made to find out if the applicants have alternative sources of finance: what they would do if they did not get the subsidised credit. If they would simply finance the investment from other sources there would be a strong case for denying them access to the limited supplies of subsidised credit. They will undertake the investment anyway, and they should be encouraged to exploit the alternative sources of finance. This is not to say that subsidised credit should not go to people who obviously have alternative ways of financing investments: off-farm income, bank accounts, etc., because one would still want to encourage them to ^{make} socially valuable investments that to them are only marginally worth while. These people would be eligible for investments on social versus private returns grounds, but not on income distribution grounds which we have rejected as important grounds for giving subsidised credit.

Subsidised credit should be used where differences between private and social evaluations of costs and returns are likely to be greatest: where the subjective evaluation of risk is obviously much higher than the objective evaluation, where first innovators obviously face difficulties, where first innovators need to be convinced, and where people need be educated through experience in the management of credit. This means favouring new innovations generally, first innovators particularly people near subsistence levels of living for whom the risk of failure is very significant, and people who need educating through experience in the use and management of credit.

Much of the subsidised credit is being given in Kenya at present without any very clear purpose in mind. The selection criteria that have evolved to try to achieve satisfactory repayment levels, have only incidentally served the purposes for which the subsidised credit might be justified. Selection criteria like the availability of regular sources of off-farm income, the availability of sufficient land, skills and other resources to follow through the investment, and a good reputation in the local community, do not necessarily identify those who need and would make good use of the credit. But as it happens there is probably not as much of a conflict between these criteria and the purpose of providing subsidised credit that is supported here, as is usually assumed. The smallholders identified by the above selection criteria may often be the first innovators; they may often be the people who face subjective risks associated with new innovations that are much higher than objective risks. But they are not people who are likely to rate the consequences of failure unduly highly, or people who particularly need to learn through experience how to manage credit.

Thus, the case for subsidised credit (if there is a case at all) rests more on divergences between social and private costs and returns than on grounds such as income distribution in Kenya at present, and selection criteria should bear this in mind.

VI. The Institutional Structure

In this section, alternative institutional arrangements for financing smallholder investments are described and compared, building up from one extreme in which there is no credit provision at all. Providing no credit facilities at all means accepting a natural process of selection in the finance of smallholder investments. In the extreme situation in which all smallholder investment is financed from past savings on the smallholding, a built-in selection criterion is implied. Smallholders who have built up surpluses from lucrative activities in the past have proved in some sense that they can make a success of farming (or other) activities, and this is not a bad criterion for deciding that they are the ones who should have the funds for further investments. The trouble with this criterion is that it biasses the selection against the younger, newer farmers who may be as good at investing as the older-established, and it biasses the selection against farmers who have large commitments on behalf of their dependents or otherwise, whose past successes do not generate much in the way of savings. If there is no market in credit, this also means that funds can be kept in inferior uses, as there is no incentive for those with funds to allow them to be used by others without who may be able to make better use of them. Thus, the built-in process of selection that is involved in the absence of any credit facilities has a crude rationale with major deficiencies.

The next possibility is to leave it to the market to perform the role of channelling funds from those who have them to those who can make best use of them. Those who want credit badly enough because they think they can get high returns from the use of the credit can try to borrow from relatives, friends, traders and others who have funds. Those who have funds but no particularly good use for them may be encouraged to lend for a reasonable return. If there were a sufficiently strong demand for

credit from those who do not have funds, and if there were sufficient funds in the hands of people who could not make good use of them, one would expect a slow development of local practices and local institutions resulting in a market for funds. This takes time, particularly in an economy in which even the use of money is relatively recent, and when it does develop it does not always develop satisfactorily as the experience of many Asian countries suggests. There is an understandable reluctance to encourage any development of this kind that might result in the heavy indebtedness of smallholders to individual moneylenders who can then exploit the situation. But once this possibility is recognised, one might question whether it would not be possible to control development of local markets for funds in such a way as to avoid the exploitation of smallholders. There is certainly no reason why the operations of moneylenders could not be regulated in such a way as to prevent gross exploitation from occurring.

There is some evidence to suggest that credit facilities are already quite extensive in the rural areas, channelling funds from those who have to those who need them. The existing sources are undoubtedly facilitating a great deal of smallholder investment already. However, until some established practices evolve, including some recognition of the concept of an interest rate, it is difficult to see how these informal flows of funds can be channelled very efficiently. The possibility of giving some encouragement to existing informal channels with a view to regularising their practices in a recognisable way might be considered as one of the means of encouraging the provision of credit to smallholders on commercial terms.

The cooperative marketing societies might be considered here as institutions which were providing credit

in a very informal way until recently, and which are now being used more systematically as part of the official cooperative credit scheme. The quotation from the Development Plan which was given earlier in the paper, made it quite clear that many cooperative societies had been giving credit haphazardly, "without specific conditions concerning repayment periods and interest rates, etc., being specified", and that the amount of such credit outstanding in 1968 was thought to be very substantial. The position is now being regularised, slowly, and cooperatives are now being used as part of a national credit structure.

The advantages of using the locally based institutions like traders and cooperative societies are that they have easy access to local views on the integrity of the applicants, and the potential of the investments, which should help them to make efficient selections. They have good informal supervision possibilities, it being relatively easy to keep informed on the use to which funds are being put, the success of the enterprise, and the case for leniency in repayment difficulties. They have access to strong sanctions in the event of default: they can insist on local guarantors, or they can rely on the normal sanctions of a well developed credit structure in which defaulters are excluded from future credit provision. In the case of cooperatives, the element of joint responsibility for loan repayments can be used to bring fellow cooperators into the enforcement process. All of these advantages are substantial, but there are disadvantages that also need to be considered. The disadvantages of using locally based institutions for credit provision is that they are vulnerable to local political influence, that they may find it unwise or impossible to refuse loans to influential members of the community, and to insist on repayment from these influential members when repayment falls due. They may

also be open to bribery from those who can afford the bribes. It is also argued, that the providers of credit may in turn exert undue influence over their debtors, particularly their less influential debtors. These fears have been used as very powerful counter arguments to any increased reliance on locally based institutions for the provision of smallholder credit. Yet, there are ways of guarding against the worst excesses, like regulating the size of individual loans to avoid a major proportion of the funds being used for one or two influential people, as in the cooperative production credit scheme. Political influence is used at the centre as much as at the local level. Local institutions have to be allowed to develop their own methods of containing the stronger pressures.³² It is difficult to see why local credit institutions should not be developed successfully with some of the supervision and safeguards that are possible; and it would be a pity to deny all the obvious advantages that these institutions have over the more bureaucratic alternatives that operate in a less decentralised fashion.

At the national level, there is also case for some specialised agricultural credit institutions. In many countries, as in Kenya, it has been decided that specialised agricultural credit institutions are necessary because of the expertise required and the special nature of agricultural credit. The risks involved in agricultural production, the relative isolation of farmers, the technical aspects of farm businesses that give rise to special problems of evaluation, all make agricultural credit very different from other forms of credit. There is thus a case for specialisation in the provision of agricultural credit. Whether this is through a statutory corporation or a commercial enterprise that is given special encouragement, and whether through a specialised institution or a more general institution is a different matter. In Kenya, the statutory corporation has been

chosen as the major institution in this field, but the Cooperative Bank is also being used in a similar capacity, and the commercial banks are being encouraged to move in this direction combining more expertise with respect to agricultural credit with their other operations.

The major problem with the official credit corporation, and to a similar extent with the commercial banks' smallholder credit operations, is the degree of centralisation of decision-making, the relative weakness of the district offices, and the total lack of integration with the local community organisations. There is a top-heavy headquarters operation combined with a field staff very thinly spread over wide areas, unable to exploit the local knowledge that would be valuable, and unable to exploit local sanctions and supervision possibilities. The national corporation is said to be reliable, less open to local political influence, less open to corruption. But it loses out in not knowing its clientele, not being able to evaluate well the viability of investment propositions in specific local conditions, not being able to follow up loans that have been disbursed, and not being able to enforce repayments except through the cumbersome machinery of legal sanctions. AFC is intending to decentralise its machinery giving more power to branch officers, but this still misses the advantages of operating through local institutions below the district level.

What should be explored is the possibility of combining the national specialised corporation with a hierarchy, a credit structure that goes right down to the local community level. This is something that the cooperative credit scheme ^{does: the cooperative credit scheme} looks promising in that respect. It is something totally alien to the present AFC organisation, however, and something that would require very radical departures in thinking, in organisation and in the development of the local institutions that could form the base of a national credit structure.

VII. Summary and Conclusions

In this paper the smallholder credit position in Kenya has been reviewed and some major issues have been discussed. It has been argued that smallholder credit programmes should be considered in their macro-economic context; that there is a strong case for encouraging the provision of credit on commercial terms alongside subsidised credit; that the provision of subsidised credit should be with specific purposes in mind, and that it should be provided on a limited scale for those purposes only; that alternative measures should be used for redistributing income to smallholders and for encouraging smallholder production; and that thought should be given to the possibility of developing a national smallholder credit structure that goes right down to the local community and uses the substantial comparative advantages of local institutions in performing some of the functions necessary.

Footnotes:

1. "Commercial rates" are defined as rates that are economic from the point of view of a commercial institution for the purposes of this paper. They should not be confused with the rates that are currently charged by commercial institutions most of which are not economic as is argued later.
2. Marris and Somerset P. 153-161 and seminar and informal discussions with people working in rural areas confirm that smallholders borrow from these different channels and that the terms of borrowing are not yet institutionalised.
3. The ALDEV 1946-62 report (p.288) states that the smallholder loans started in 1955. This appears to be an error as the ALDEV 1946-55 report (p.213) says they started in 1948, as does the Development Plan 1966-70 describing ALDEV loans.
4. Vasthoff, p.36
5. ALDEV 1946-55, p.291;ALDEV 1946-62, p.213.
6. Development Plan 1966-70, p. 354
7. Vasthoff, p. 30-31
8. Von Pischke.
9. Development Plan 1970-74, p.280
10. Von Pischke, p. 5, p.18
11. KTDA, Annual Reports. Planting material loans may have been started again recently by the KTDA, but this remains to be confirmed.
12. Pyrethrum Board, Annual Reports and material supplied by Von Pischke.
13. Cotton Lint and Seed Marketing Board, Annual Reports.
14. Vasthoff, p. 22
15. Wilson, p. 13
16. Wilson, p. 12
17. Vasthoff, p. 22
18. Wilson, p. 13
19. AFC, Annual Report 1970/71
20. It would be interesting to discuss what this opportunity cost is.

Footnotes cont'd

21. AFC, Annual Reports
22. Wilson, p. 17
23. Wilson, p. 17. This information comes from Kisii. It is not clear whether the relative positions of the different banks are the same in other parts of the country.
24. Information on the Vihiga maize /credit package was collected by the author and F. Hay as part of an ad hoc evaluation of the SRDP undertaken by the IDS in 1972. The report which could serve as a reference has not yet been released. Unfortunately it has not been possible to include 1973 information in this version of this paper.
25. A. Ascroft, N. Roling, J. Kariuki, F. Chege, The Tetu Extension Project: First Report on a Field Experiment, IDS, August 1972.
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27. Ruthenberg; Mbithi; statistical Abstract Survey of Non-Agricultural Enterprises; Press; etc.
28. Von Pischke, p. 12
29. Contrast with Indian agriculture in which land improvements, water development, small-scale equipment etc. adds up to substantial capital formation in many areas.
30. Verbal communication from I. Inukai who found some cases of seasonal credit from traders and among kin involving very high implicit interest rates.
31. It is only if foreign aid is available for smallholder credit and no other purpose that this is not true.
32. Marris and Somerset gives a good account of the ways in which entrepreneurs in different fields have done this.

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