

Socio Economic Factors Affecting non Recovery of Agricultural Credits in Sri Lanka: A Case Study on Short Term Loan for Paddy Farmers in Rajanganaya Cultivation Area

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ABSTRACT

Higher default rate of agricultural credit is a major problem in rural financial sector. In this study, an attempt was made to identify the major factors that are associated with default of agricultural credit. A questionnaire survey was conducted with creditors in Rajanganaya cultivation area. Result of Chi-square analysis technique showed that the default of agricultural credit was associated with extent of cultivation, loan amount and income of production. Descriptive analysis revealed that the farmers' negligence was the major reason for default of agricultural credit (46%). Poor marketing system was a major problem for farmers. By providing close supervision and introducing a system such as contract farming, default rate can be reduced.

KEY WORDS -Agricultural Credit, Rural Financial Market, Rural Credit

INTRODUCTION

Sri Lanka is an Agricultural based economic country. The agriculture sector of Sri Lanka plays a significant role by contributing 17.9 percent to the G.D.P. and generating 32% of employment opportunities (Anon, 2004). Around 78 percent of the total population of Sri Lanka lives in rural areas (Bandarathilaka, 2002). Almost 90% of this portion is considered poor in which most of them are farmers (Anon, 2004).

The cost of production of agricultural commodities has increased in Sri Lanka (Anon, 2004). The shortage of capital has been a major problem in the sector. Agricultural credit in Sri Lanka is a major input in cultivation. With the introduction of the credit facilities for the agriculture sector in 1947, the government has been trying to develop and expand its availability.

The term credit is defined as "a sum of money in favor of person to whom control over it is transferred" (Frank Ellis, 1996). Government has imposed policies to promote agricultural credit and a large share (66 million for 2003) is spent to supply 50% of credit subsidy for default of agricultural credit. There are two types of rural financial markets in Sri Lanka namely Well organized rural financial market and unorganized rural financial market (Sanderatne, 2002). Only 10% of credit requirement of farmers is fulfilled by organized financial market while unorganized rural financial market contributes to the rest (Sampath and Sanderathna, 2001). The interest rate of agricultural credits (8%) is identified to be lower than the other trade credits resulting a lower profit margin for organized rural financial institutes. Moreover, the average recovery rate reads only 82% in 2004, which implies the higher risk in agricultural credits (Table 01). Consequently, the organized financial institutes have granted credit for identified, guaranteed, customers, to get rid of risk (Dasanayake, 2004).

This creates an unequal credit distribution. Therefore the farmers with low income have been aided by unorganized rural financial market, where higher interest rates are prevailing.

As long as the farmers depend on the so-called unorganized financial market, a higher portion of their income will be exploited for paying interest. This affects adversely for the living standard of farmers and will result a continuous "Viscous" cycle in rural areas (Lipse and Harybory, 1992).

The objectives of this study were to identify the Socio-economic factors associated with default of agricultural credit and to promote granting more credits for the agriculture sector via financial organizations. Further it was necessary to identify strategies to increase the recovery of agricultural credit and to provide with guidance to establish new productive loan scheme in Sri Lanka.

Table 01-Agricultural credit recovery percentage (paddy):

Cultivation year		Recovery percentage
1999/2000	Maha	88.44
2000	Yala	88.19
2000/2001	Maha	93.96
2001	Yala	93.15
2001/2001	Maha	94.50
2002	Yala	97.59
2002/2003	Maha	93.73
2003	Yala	92.68
2003/2004	Maha	81.23
2004	Yala	81.37
2004/2005	Maha	18.29

Source- Central bank annual report 2004 in Sri Lanka

METHODOLOGY

This study was conducted at Rajanganaya cultivation project from December 2004 to June 2005. The area is demarcated by Puttlam, Anuradhapura, and Kurunegala districts. Rajanganaya is an area with higher production in paddy cultivation and it is a place

where different farmer settlements have been taken place.

The sample consisted of 61 farmers who obtained loans and registered in farmer organization. Cluster sampling method was practiced to select farmers in each region (track 1 to 7). Structured questionnaires were used to collect data through direct interview method.

Chi-square Technique was used to identify association between selected factors and default of loan.

$$\chi^2 = \frac{\sum (X_{ij} - M_{ij})^2}{M_{ij}}$$

χ^2 = the Pearson's Chi-square statistic value

X = Stands for observed cell count

M_{ij} = expected cell count in i^{th} and j^{th} column

P = .000* Significant Probability value at 95% confident level

Selected factors were categorized as follows.

1) Extent of Cultivated Land

According to the land size two groups were identified, High = >2ac, Low = <=2ac

2) Loan Amount

Two groups were identified According to the amount of loan, High = >Rs10000, Low = <= Rs10000

3) Experience in Farming

Farmers were divided into another three groups in terms of farming experience.

Group 1=0-10 years, Group 2=11-20years,

Group 3=more than 20years

4) Number of family members

The number of family members was used as the base for identifying another three groups.

Group 1= 3 members in family,

Group 2= 4 members in family

Group 3= Number of family members equal to 5 or more than 5.

5) Product income

Two groups were identified according to the product income.

High = > Rs50000, Low = <= Rs50000

6) Educational Level

Education was divided into three groups.

Primary = < grade 5,

Secondary = 5 grade <, > O/L, Tertiary = > O/L

Marketing, Insurance were analyzed by using descriptive methods.

RESULTS AND DISCUSSION

Table 02. Extent of Cultivation.

	Pay	Not Pay
Low	40%	60%
High	79%	21%

Significant association at P < 0.05*

Extent of cultivation was associated with default of agricultural credit. Sixty percent of farmers in low extent land category had not paid loan back, whereas, it was only 21% of farmers, in high land category (Table 02) with the increase of cultivated land extent the production and the income gained had increased.

Table 03. Loan amount

	Pay	Not Pay
Low	30 %	70 %
High	71 %	29 %

Significant association at P < 0.05*

Default of agriculture credit was associated with the amount of loan. In the low amount category 70% of farmers had not paid loan while it was 29% in higher amount category (Table 03). When farmers were granted with small amount of credit, the objectives of granting the credit were rarely achieved as most, the credit were used for day-to-day household consumption.

Major reason for loan default can be identified as negligence of farmers in repayments where 46% of farmers showed it. Nineteen percent of farmers have failed repaying due to misuse of their credit on other purposes. The higher portion of credit was used for cultivation when farmers obtained large amount of loans and they had higher mental commitment for repayment of loan after selling their products. However, both categories had not used total loan amount for cultivation.

Table 04. Experience in farming

	Pay	Not pays
Group 1	39%	61%
Group 2	47%	53%
Group 3	65%	35%

$\chi^2 = 3.26696$ P = 0.1950

Farming experience was not associated with default of loan, whereas group 2 had the greatest default rate.

Table 05. Number of family members

	Pay	Not pays
Group 1	56 %	44 %
Group 2	35 %	65 %
Group 3	61 %	39 %

$\chi^2 = 2.8657$ P = 0.2386

There was no association between Number of family members and default of agriculture credit at 95% confident level. Group 2 had the highest default rate of agricultural credit (Table 05).

In general, with the increase of family members repayment ability could be reduced, because of the higher cost of living. However, the study proved that

there was no effect of the number of family members on default of agricultural credit.

Table 06. Income of production

	Pay	Not pay
Low	38 %	62 %
High	85 %	15 %

Significant association at $P < 0.05^*$

Product income was associated with the default of agricultural credit. In low product income category, 62 % of farmers had not paid loan, while in higher income group 15 % of farmers did not pay loans (Table 06). Default percentage in low income group was significantly higher than that of high income group.

Generally with the increase of the income from production, the repayment ability had increased. It affected positively to increase recovery rate of agricultural credit.

Table 07. Educational levels

	Pay	Not pays
Primary	58 %	42 %
Secondary	45 %	55 %
Thesauri	67 %	33 %

$\chi^2 = 1.44841$ $P = 0.4847$

Educational level was not associated with default of agricultural credit. Default percentage in secondary educational level was higher than that of primary and tertiary education levels.

Marketing

Percentage of farmers

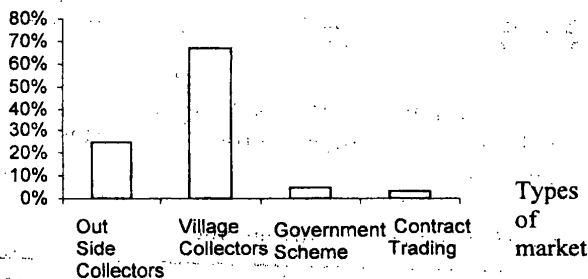


Fig. 1 Distribution of paddy market

Sources - Authors

Sixty seven percent of farmers had sold their products to village collectors while 25% of farmers had sold products to out side collectors and 5% of farmers had sold products to Government scheme while, only 3% of farmers performed according to contract farming system.

Most of the farmers were compelled to sell (67%) their product to village collectors at low prices than the market price because they had borrowed

inputs such as fertilizer, pesticides and other agro chemicals under credit facilities of village traders.

Further they had borrowed money to fulfill their daily need with the promise of selling the products to village collectors after harvesting.

As a result, they were unable to sell their products to others though the price offer was higher. It directly affected on the income reduction of farmers. In addition, farmers could not get other benefits, such as discounts for pesticides and fertilizers when they received it under credit scheme.

It was further revealed that, only 8% of farmers (contract and government scheme) got efficient market price to sell their products and rest of the farmers (92%) were unable to access the effective market to sell their products. Ineffective traditional marketing system directly affected to reduce income of the farmers. It caused an increase in default of agricultural credit. To change the prevailing condition of market, government had introduced several programmes such as purchasing products at guaranteed price. However, it has not sufficient enough to solve this market failure. As a development, a new concept, contract farming system had also been introduced

Insurance

Percentage of farmers

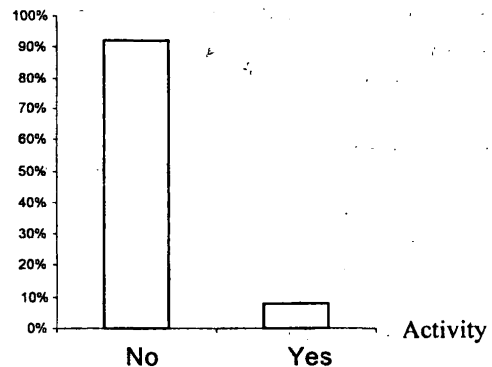


Fig. 2 Insurance activity of farmers

Sources- Authors

It is revealed that 92% of farmers had not followed crop insurance policies. While only 8% of farmers follow the crop insurance policies.

Crop insurance policies had been introduced to reduce risk of agriculture. However, it had not been used properly. Most of the farmers do not have clear idea about the importance of insurance policies. Hence farmers consider an unnecessary expenditure.

CONCLUSIONS AND RECOMMENDATIONS

The results of the study revealed that, the extent of land, amount of loan and income of production were associated with default of agricultural credit. However, experience in farming, number of family members and educational levels were not associated with default of agricultural credits.

The use of high yielding varieties and effective methods of cultivation could be recommended to increase the productivity because there are limitations to increase the extent of cultivation. The study further revealed that negligence of farmers who borrowed small amounts of agricultural credit was the major reason for default of agricultural credits (46%). Misuse and unproductive application of the credits granted were other reasons for default of credit (20%).

To reduce rates of default agricultural credits, closer supervision on farmers by financial organizations from the time of granting to full recovery is necessary. Ineffective marketing system was another major reason to reduce farmer income. Interference of financial organizations to promote effective marketing system is essential to recover this. Financial organizations can help farmers in establishing a trade agreement between farmers and traders. Introducing a credit card system for farmers is important to increase relationship between financial organizations and farmers. It helps to expand and strengthen the business in financial organizations.

Farmers should be encouraged to obtain crop insurance, and insurance institutions should increase their efficiency and effectiveness further to increase stability in the agriculture sector.

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