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Agricultural policy reform and national farm credit policy

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Abstract. Since 1986, regulatory Egyptian agriculture mechanism has been gradually abolished. The agricultural economy has been transformed from an emphasized central planning into a system responsive to the economic signals governed by a free market system. This policy aims to encourage producers to use more investments in agricultural activities and to adopt new technologies which can increase their productivity and the net farm income. National farm credit policy was set up to gradually abolish the subsidy on credit, i.e. interest rates on loans aligned on market rates, and to restrict the total subsidy on interest for all types of farm credit to no more than L.E. 105 million per year. As the new credit policy started by the fiscal year 1988/89, it is too early to assess its impact during this short time. However, in addition to those measures dealing directly with the farming world, lending operations of the PBDAC should be extended to agro-based businesses and other non-agricultural rural based enterprises.

Keywords. Farm policy - Credit policy - Egypt

Titre. *La réforme de la politique agricole et la politique nationale de crédit à l'agriculture*

Résumé. *Depuis 1986, le système de régulation de l'agriculture égyptienne a été graduellement aboli. L'économie agricole est passée d'une planification centralisée très accentuée à un système gouverné par les règles du marché libre. Cette politique a pour objectif d'encourager les producteurs à davantage investir dans les activités agricoles et à adopter les nouvelles technologies de façon à accroître la productivité et le revenu net agricole. La politique nationale des crédits à l'agriculture a été mise en place pour abolir graduellement les crédits subventionnés, par l'alignement des taux d'intérêt agricoles sur les taux du marché, et pour réduire le total des subventions pour tous les types de crédits dans l'agriculture à un montant maximum de 105 millions de livres égyptiennes/an. Etant donné que la nouvelle politique de crédit a débuté lors de l'année fiscale 1988/1989, il est encore trop tôt pour en évaluer l'impact. Toutefois, la PBDAC va étendre ces mesures, concernant directement le monde agricole, à toutes les entreprises développant des activités liées à l'agriculture ainsi qu'à toutes les autres entreprises localisées en milieu rural.*

Mots clés. *Politique agricole - Politique du crédit - Egypte*

I – Introduction

Let's begin by an historical background. Egypt was self-sufficient in agriculture during 5 000 years, and its crops surpluses were the basis of the great dynasties of Antiquity. In the early twentieth century, Egypt knew a rapid population growth creating a steadily increasing demand on the agriculture sector. The green revolution and other technological innovations have demonstrated that agricultural productivity can be increased widely. Egyptian farmers are known to be capable and productive when they were given adequate incentives. But, now and henceforth, the Egyptian agricultural sector is stagnant, with no real growth in the recent years.

Only 15 years ago, the Egyptian economy presented a positive balance of payments. However, at the beginning of the 1970s, the Government of Egypt increasingly tightened the regulation of agricultural production in order to provide cheap food to the urban sector. Crops prices were controlled and production quotas assigned. In order to persuade farmers to produce crops at low prices, it became necessary to provide credits and inputs (fertilizers, ...) at subsidized prices. The Government increased its control by becoming the only distributor of these inputs. The impact of this regulatory mechanism on the agricultural sector includes the following:

- Production is controlled through a central program of land use related to cropping patterns (use of fertilizers, chemicals and seeds as well as mechanization);

- ❑ Farm returns depend on crops regulation and inputs prices as well as dumping of subsidized food-stuffs on the market;
- ❑ Marketing is controlled by requiring farmers to sell some of their crops to the Principal Bank for Development and Agricultural Credit (PBDAC)¹ or to government cooperatives, often below open market prices and by controlling the exports of certain crops;
- ❑ Inputs distribution is controlled through the public sector monopoly and restrictions on private sector rates of return, including complicated regulations on trade;
- ❑ Technology diffusion is limited by restricting farmers buying on credit «packages» of inputs which do not efficiently fit their needs;
- ❑ Credit is restricted by regulating interests at unattractive rates to commercial lenders, by high collateral requirements and by a limited portfolio of eligible investments.

Controlled crop prices and the central regulation of inputs as well as the procurement control system have resulted in a stagnating agricultural economy. Government statistics indicate a real deterioration of the agricultural production during the period 1980-1984. All this has been emphasized by the growth of the Egyptian population: 2,9% per year, which requires an equivalent increase in the agricultural production just to keep up terms per capita.

Moreover, the further migration from rural to urban areas aggravated the problem. The population of Cairo has doubled since the end of the 1960s like that of other Egyptian cities which have also grown very rapidly, leading to an increasing demand for cheap subsidized food. These factors have pushed food self-sufficiency (domestic production divided by domestic consumption) into a steadily downward trend.

Maintaining subsidies for the input supply system in the centrally managed farm imposed a considerable strain on the Government of Egypt budget. Direct government subsidies for agricultural credits rose from L.E. 40 million in 1981 to L.E. 62 million in 1985. Inputs subsidies soared from L.E. 100 million in 1978 to L.E. 340 million in 1983; allotments of fertilizers and other inputs were also increasing. Nevertheless, significant shortages in particular types of fertilizers began to appear by the end of 1985 and agricultural production declined.

II – The Egyptian policy reform

The Government of Egypt has indicated its intention to restructure the economy and the policies related to the agricultural sector as well as to modify the operating procedures of the state organizations which implement those policies. The agricultural economy must be transformed from a government planning and regulation system into a new one submitted to the free market system.

The agricultural reform program, settled in June 1986, to help agricultural development in Egypt consisted of nine measures:

- ❑ liberalize prices for all crops in three years, except for cotton, sugar and rice;
- ❑ liberalize cotton, sugar and rice prices by 1998;
- ❑ eliminate quota delivery (compulsory procurement at fixed prices) for all crops except for cotton, sugar and rice by 1986; and the last three after 1995;
- ❑ eliminate mandates on cropping patterns except for rice, sugar and cotton by 1989. Prices and trade opportunities will determine farmers' choice to get high value crops with export possibilities;
- ❑ limit state ownership of land at 4% and use it for agricultural experiments and crop testings; all the additional land will be sold to the private sector;
- ❑ liberalize import prices (so that subsidies are eliminated);
- ❑ eliminate the public sector monopoly for inputs distribution and include the private sector (so that subsidies are eliminated);

- encourage young people to operate small modern farms;
- promote applied research through contracts with research centers and institutions.

This new agricultural policy aims to encourage Egyptian farmers to use more investments in the agricultural activities and to adopt new technologies that can increase their productivity and the net farm income.

In encouraging young people to operate small modern farms, the Egyptian Government expects:

- establishing new settlement communities and releasing the stress of population on the ancient land of the Delta and the Valley;
- creating new employment opportunities for resolving the unemployment problems that young people have to face and for reinforcing the economy;
- generating new sources for increasing the national income;
- raising crops yield by encouraging young people to apply new technologies in agriculture.

In the economic theory, it is well known that governmental interference by controlled policies leads to generate various benefits for consumers but not for producers. According to the reform programme, supply and demand forces will dictate the real prices for commodities, inputs, etc. This is expected to provide more benefits to producers rather than to consumers.

III – The national credit policy

Concerning the farm credit, the new policy includes the following measures:

- Subsidized credit will be restricted to a maximum per feddan;
- Interest rates on all other new loans will be aligned on market rates;
- Total interest subsidies related to all types of farm credit will not exceed L.E. 105 million per year.

This report indicates that the Egyptian Government wants to consolidate the role of the Principal Bank for Development and Agricultural Credit (PBDAC) as a specialized credit guarantee organization, orientating its main activities towards fulfilling credit services by increasing non-subsidized agricultural loans and raising the interest rate to market levels.

Without any doubt, credit is an important factor for the achievement of the agricultural development. Through it, the private sector can apply new agricultural technologies which will increase farm production. One of the most important mechanisms of this policy is the subsidized interest rate which, in the past, allowed farmers to receive loans for various activities related to agricultural production at a low cost.

1. Volume of loans made by the PBDAC

Table 1 presents data on the volume of loans made by the PBDAC during two recent fiscal years: loans are made to finance annual crops production only. These loans are made for purposes of mechanization, for land reclamation or as food security loans, all of them for different duration. Short-term loans are for less than one year, medium-term loans are for 1-3 years and long-term loans are for more than three years.

These data indicate that the amount of all agricultural loans of all types and duration reached 2,993 million for 1988/89. Short-term investment loans represented 49% of this total followed by agricultural production loans with 33%; then medium-term investment loans at 18%; while long-term investment loans represented a mere 0,2% of all loans in that fiscal year.

Table 1. Agricultural loans by the PBDAC (1988/89 and 1989/90)

Types of loan	Subsidized		Non-subsidized		All loans	
	in million LE	(%)	in million LE	(%)	in million LE	(%)
1988/1989						
Crop production:	748,2	8,3	227,3	11	975,5	33
Investment Loans:						
Short-term	57,3	6	1406,6	67	1463,9	49
Medium-term	88,0	10	459,5	22	547,5	18
Long-term	5,9	1	0,2	*	6,1	*
Total loans	899,4	100	2093,6	100	2993,0	100
1989/1990						
Crop production:	960,3	86	313,5	12	1273,8	34
Investment loans:						
Short-term	14,9	1	1520,0	57	1534,8	41
Medium-term	127,6	11	828,5	31	956,2	25
Long-term	11,7	1	0,2	*	11,9	*
Total loans	1144,5	100	2662,1	100	3776,7	100

Source: PBDAC
* = less than 1%

In 1989/90, total loans increased to L.E. 3,777 million, i. e. 26%. Although short-term investment loans increased to L.E. 1,535 million, their relative importance declined to 41% in the total credit. The latter were followed by agricultural production loans, representing 34% of all loans. Medium-term investment loans were around 25%. Long-term investment loans remained the smallest group, although there was a slight rise to 0,3% of the total credit granted that year.

2. Trends of loans in the agricultural sector

A. Trends in the growth of farm loans

Table 1 shows an increase in the volume of crop production loans from 976 million L.E. in 1988/89 to 1,274 million L.E. in 1989/90, i. e. 33%. This rate points out the growing farmers' tendency to use PBDAC credits to finance their production operations. However, a part of this augmentation is also due to higher prices of inputs.

The data also show that while subsidized crop production loans increased from L.E. 748 million to L.E. 960 million, i. e. a progression of 28%, non-subsidized crop production loans increased from L.E. 227 million to L.E. 313.5 million, i. e. 38%.

B. Trends in the growth of investment loans

The volume of investment loans also increased between 1988/89 and 1989/90. Short-term loans increased by 5%, medium-term loans by 75%, and long-term loans by 96%. The data in Table 1 show that subsidized short-term credit almost disappeared, as it decreased from L.E. 57 million to L.E. 15 million, i. e. 2% to 0,4% of total loans.

C. Trends in subsidized credits

In terms of subsidized credits, crop production loans represented the largest category in both years, 83% in 1988/89 and 86% in 1989/90. In second position were medium-term investment loans which constituted 10% in 1988/89 and 11,5% in 1989/91. Short-term subsidized investment loans decreased during this period from 6% to 1,3%. Subsidized investment loans for all duration increased by 22%, i. e. 151 million to L.E. 184 million.

D. Trends in non-subsidized credits

For non-subsidized credits, short-term investment loans represented the largest category during 1988/89, amounting to 67%, but, in spite of an increase in the volume during 1989/90, the relative importance declined to 57%. This result is due to the increase in medium-term investment loans, from L.E. 459 million to L.E. 829 million.

During the same period, the total amount of non-subsidized investment credits increased from L.E. 1,866 million to L.E. 2,349 million, i. e. an increase of 26%. Hence, we see that the PBDAC has increased non-subsidized credits according to the expense of subsidized credits.

E. Trends in interest rates

Table 2 shows the changes which have occurred in interest rates for all types of agricultural loans during the past few years. This table is made from the dates when changes were made in interest rates and which do not coincide with fiscal years.

Table 2. Interest rates charged by the PBDAC on agricultural loans (in %)

Types of loan	Interest rates					
	(1)		(2)		(3)	
	from 23/4/87 to 14/5/89		from 15/5/89 to 13/2/91		since 14/2/91	
	Subsid.	Non-sub.	Subsid.	Non-sub.	Subsid.	Non-sub.
Crop production	3	13	5	15	5	15
Mechanization	10	14-15	12	16-17	12	17
Food security	9	14-15	11	16-17	11	17
Land reclamation	6	14-15	8	16-17	8	17

Source: PBDAC

(1) Interest rates set on 23/4/87 at 13% for loans less than 1 year, 14% for loans of 1-2 years, and 15% if over 2 years.

(2) Interest rates for all new loans which were raised by 2 on 15/5/89.

(3) The non subsidized rate on crop production loans set generally at 15%, except for fruit crops which were set at 16% and vegetable crops at 17% because of their rentability.

In addition to the interest rates described in Table 2, the PBDAC took a commission or charge for administrative costs of 0,5% for mechanization and land reclamation loans and 1% for food security and crop production loans. Most of the food security loans concerned the national veal project.

Interest subsidies are provided to PBDAC by the Ministry of Finance. Accounting of the subsidies is carried out on the basis of the differences between the subsidized and non-subsidized interest rates as given in Table 2.

From Tables 1 and 2, it is clear that subsidized interests have touched any type of loan. However, the category which benefited from them, both in terms of total loans and of interest subsidies, was the crop production loan.

F. Volume of interest rate subsidies

The reform in agricultural economic policy aims to liberate farmers from the compulsory delivery quotas of most of the crops and to make prices determined by the market. Compulsory delivery is now restricted to cotton and sugar cane. This new policy will allow farmer delivery prices to eventually look for an equilibrium with the level of production costs and a suitable margin of profit to the farmers. The policy also aims at expanding the cultivation of oil crops so as to reduce the gap between domestic production and consumption and to encourage the production of sugar beets in order to fulfill the country's requirements for sugar.

The total volume of the interest subsidy is determined by the credit terms on those crops which were previously agreed upon by the Deputy Prime Minister (Ministry of Agriculture) on November 1984. According to this agreement, the subsidization of the interest on agricultural loans was calculated.

As shown in Table 3, the subsidization of the interest on the above mentioned crops for 1990/91 was set according to the following criteria:

- Limits for subsidized loans were established for these strategic crops depending upon the costs of production. The loan limit for sugar cane was set at L.E. 650 per feddan, approximately half of the estimated production cost. Loan limits for the other strategic crops were set at approximately one-third of production costs;
- The interest subsidization rate for crops production loans was set at 10%. Thus, on subsidized crops loans, the farmer is paying an interest rate of 5%, plus the 1% PBDAC commission. The Ministry of Finance will pay the balance of the interest (10%) on these loans.

Table 3. Budgeted interest subsidy on crop production loans for priority crops (1990/1991)

Strategic crops	Area of crop (in 1000 FD)	Production cost (L.E./FD)	Loan limit (L.E./FD)	Subsidized loans (in million L.E.)	Amount of subsidy (in million L.E.)
Cotton	1 100	716	250	275,0	27,5
Rice	1 010	609	200	202,0	20,2
Sugar cane	275	1 200	650	178,8	17,9
Sugar beet	50	500	160	8,0	0,8
Oil Crops	200	600	200	40,0	4,0
Total				703,8	70,4

Source: PBDAC

FD: feddan, it is the Egyptian unit measure equivalent to 1 038 acres or 0,42 hectare

The rate of subsidization of investment loans varies with the type of loan. Non-subsidized investment loans carry an interest rate of 17%. Thus, for example, a non-subsidized mechanization loan will cost to the investor 17% of interest plus the PBDAC commission of 0,5%. With subsidized mechanization loan, the Ministry of Finance would pay 5% of the interest and the investor will pay 12% plus the commission.

Government of Egypt funds are used to subsidize both crop production and long-term investment in agriculture according to the nature of their activities and the Egyptian policy regarding their subsidization. The amount of funds for that purpose, for 1988/89, was as follows:

Types of Credit	Amount of funds (in million LE)
Crop production loans	83,7
Agricultural mechanization loans	12,7
Land reclamation loans	3,1
Food security loans	5,5
Total	105,0

The total interest subsidy in 1989/90 rose to L.E. 112 million. This unexpected augmentation occurred due to an increasing demand and a lack of accounting control on in-kind loans. However, according to the decisions to restrict the subsidization of crop production loans for strategic crops only, the projected subsidy on production loans in 1990/91 was expected to be L.E. 70,4 million (Table 3) with total interest subsidies for 1990/91 projected at 91,7 million.

The data in Table 3 indicate that the Government of Egypt has exceeded the requirements of *Tranche IV* and, indeed, may have fulfilled the requirements of *Tranche V*, as the subsidization of agricultural crops became restricted to only strategic crops such as cotton, rice, sugar cane, sugar beets, and oil crops. Subsidization of credit for other crops has been eliminated.

In fact, for 1990/91, subsidized production loans concerned only five strategic crops and loan limits have been established for them. Total interest subsidies for all agricultural loans in 1990/91 are projected to be below the target of L.E. 105 million.

IV – Conclusion

Though Egypt's agricultural economy is being transferred from an interventionist to a market orientated policy, the farm financial system is dominated by the PBDAC. The bank lending operations as well as its deposit mobilization is primarily concentrated on the farming community. Lending is limited and insignificant for agro-business as well as for non-agricultural rural enterprises. Consequently, in the context of promoting a broader rural development, there is scope to improve the financial services provided by the bank to the rural people. In addition, access to credit in the new lands is extremely limited, both on account of strict collateral requirements, as well as the absence of an adequate bank network in these areas³.

We must realize that the impact of any new policy deals with the effects of its projects operation and performance on rural people as it is indicated by changes in farm yield, farm incomes and their distribution, levels of nutrition, welfare, etc. So, nowadays, even for the fiscal year 1988/89, it is too early to catch its impact, the full benefits or costs in the agricultural sector. However, the cursory examination of the yield of major crops reveals that all of them have known an increase during 1989/90 and 1992/93.

	1989/1990 (Ton/Fed.)	1992/1993 (Ton/Fed.)	Variation (%)
Rice	2 722	3 216	+ 18
Wheat	2 077	2 208	+ 6
Corn	2 260	2 579	+ 14
Sugar cane	40 608	43 545	+ 7
Sugar beet	17 245	19 342	+ 12
Cotton	5 030	7 150	+ 42

We cannot describe the increase with one single factor as the production growth is naturally the combined effect of many factors. The appreciation of the pure effect of credit reform policy on crop yield would only be achieved via a more sophisticated analysis which is not the purpose of the present study.

Notes

1. PBDAC is the abbreviation for the Principal Bank for Development and Agricultural Credit. Before adopting the policy reform in 1987, PBDAC was the operational tool of the government's extension system for the management of the production and the marketing of principal crops and other products. It was the only authorized source of financing all inputs used in agricultural production such as seeds, pesticides, fertilizers, and livestock food.
2. L.E. is the Egyptian pound, the monetary unit of Egypt; L.E. 3,34 = US \$ 1 (January 1993).
3. In a farming system where 60% of the whole farmers are barely able to provide the basic needs of their family, savings to finance cash purchases are virtually non-existent. The agricultural credit policy established in 1952 allowed all of them to obtain credit mainly for their crops, rather than their land or other pattern. The benefits to the agricultural sector of this credit policy have been considerable. Small farmers have been able to finance purchases of modern inputs and tenant farmers could rent available land. Both these groups have had access to credit, which would have been difficult or impossible under strictly commercial conditions.

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