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## THE CONSTRAINTS OF AGRICULTURAL CREDIT AND GOVERNMENT POLICY STRATEGY

**Abstract:** *Inadequate loan availability in agriculture is also a result of issues with agricultural sector actors (particularly farmers) and financial institutions. Farmers continue to face barriers to credit (accessibility and unbankability) and the limited financial institutions that provide loans to agriculture. As a result, the government must implement a policy aimed at expanding the agricultural industry, particularly in light of farmer access to finance limits. Because agriculture is a high-risk business, formal institutions are less interested in funding it due to high transaction costs, asymmetric knowledge, low profitability, and a lack of collateral. Additionally, farmer education is relatively low. Additionally, due to unpredictable production and uncontrolled pricing risk, the majority of banks are unable to finance agriculture. While the farmers' constraints in obtaining formal loans are complex, they should include collateral, expensive payment delay fees, extensive distances, and a lack of information regarding capital.*

**Key words:** *agriculture, credit, government subsidies, government policy, bank loans, credits, agriculture behavior.*

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### Introduction

According to data from the Central Bureau of Statistics (BPS, 2017), agriculture is the second most influential sector of economic growth, after the processing industry. The agricultural industry as a whole contributed 13.92 percent to GDP in the second quarter of 2017, up from 13.59 percent in the first quarter. Comparing the current quarter to the previous quarter (q to q), the agriculture sector grew at the fastest rate, at 8.44 percent. This growth is a result of increased output of a variety of plantation crops, including coffee and sugar cane, as well as greater horticulture. According to data from the Indonesian Banking Statistics, credit distribution to agriculture, hunting, and forestry totaled Rp278 trillion (6.45 percent) in January 2017, while credit to the fishery sector totaled just Rp9.14 trillion (0.21 percent). NPLs reached Rp6.04 trillion (2.17 percent) and Rp384 billion (4.21 percent) in both sectors, respectively. Bank credit totaled Rp4,313 trillion as of January 2017. The agriculture industry continues to

receive very little credit from the Bank in comparison to other sectors. This is because credit risk in the agricultural industry is particularly high, as it is inextricably linked to nature. So that banks maintain a prudent attitude toward public finances and ensure that the credit extended does not become a credit problem (non-performing loan / NPL). Inadequate loan availability in agriculture is also a result of issues with agricultural sector actors (particularly farmers) and financial institutions. Farmers continue to face barriers to credit (accessibility and unbankability) and the limited financial institutions that provide loans to agriculture. As a result, the government must implement a policy aimed at expanding the agricultural industry, particularly in light of farmer access to finance limits.

### Literature Review

#### The Constraints of Agricultural Credit

Credit restrictions in agriculture According to Minh Chau Tran et al. (2016), there are certain barriers

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to agricultural credit access. Agricultural credit issues will be determined by a region's or country's economic situation. Credit as a critical source of income for agricultural households to increase their wellbeing and productivity. However, it is nearly identical to the incidence in many other developing countries, particularly among rural Vietnamese farming households. Credit to formal financial institutions is excluded due to high transaction costs and information asymmetries, a lack of guarantees, lax credit contract enforcement, and underdevelopment of insurance services, which render formal financial managers incapable of serving the market [2]. Another barrier to loan access is the disparate treatment in terms of credit availability. The distinguishing factors are the head of household's characteristics (age, sex, and education), household characteristics (factors relating to physical capital, human capital, social capital, and the economy), and geographical factors (distance to markets or formal lenders increases household transaction costs, the viability of local credit institutions, and the development of local production).

The impact of financial limits on agricultural behavior in CEE transition countries is examined by Pavel Ciaian et al. (2012). According to the theoretical model, more access to credit can result in increased productivity, agricultural output, and input utilization. Eliminating agricultural financial limits promotes the usage of all inputs [3]. Increased access to credit, on the other hand, may result in restricted credit input replacement to provide infinite input if it is asymmetrically constrained. The results of empirical testing on the hypothesis indicate that credit is restricted on farms in CEE. Access to credit boosts TFP by up to 1.9 percent with an additional EUR 1,000 in credit. Agriculture in CEE is principally constrained by credit for variable inputs and capital investments, which grow by 2.3 and 29 percent for 1,000 EUR of extra credit, respectively. Land and labor, on the other hand, are not credit-restricted. This could be explained by the relative amount of land and the high rate of agricultural worker employment in the CEE transition countries, particularly in Poland, Slovenia, and the Baltic states. Thus, the findings indicated that agriculture may handle land financing and workforce issues more effectively than input and investment variables. Family farms rely heavily on their own labor, which eliminates the need for pre-financing. Family labor can overcome credit constraints by deferring household consumption until the last period of production sales revenue collection (after harvest at the end of the season). Comparable to land. Agriculture can leverage the rental market to increase land utilization. The difficulties encountered in certain developing countries' agricultural lending policies are comparable to those encountered in Indonesia. According to Farida Siregar et al. (2015), the KUR Program was introduced by the government to achieve inclusive funding, particularly for micro

companies, through formal bank loans. 46.7 percent of 332 respondents from home micro firms had access to KUR, while the remainder did not use it to fund their operations. The findings of this study suggest a crucial determining element affecting home micro firms' access to KUR. Gender is a significant factor in determining access to KUR in home micro enterprises, with men having a greater likelihood of accessing KUR than women. Property and property ownership in the husband's name minimize the involvement of the wife in obtaining a loan. Women have minimal involvement with formal institutions and sign loan contracts as a result of their lack of expertise or education level. Their extended business tenure and access to alternate finance sources both work against their access to KUR. The primary reason is that capital requirements are met without requiring banks to provide KUR access. Another scenario is that if households suffer difficulties owing to micromarketing constraints and poor economies of scale, KUR is not the best answer.

Credit limits will undoubtedly have an effect on farmers' productive activities and welfare levels. In a paper titled "Agricultural production, credit, and farm size in Ghana: a case study of Ghana," Mamudu Abunga Akudugu (2016) explored the relationship between agricultural productivity and credit. In general, the findings indicate both formal and informal credits have a large positive effect on agricultural productivity. Formal credit has a less impact on agricultural output than informal credit. Although the size of the land is not found to be a linearly significant predictor of farm household agricultural productivity, the quadratic term is. The study's findings suggest that efforts to boost agricultural productivity in Africa in general, and Ghana in particular, should focus on determining the optimal size of agricultural land for farmers, taking into account the context in which farmers operate, in order to produce at an optimal pareto level. Thus, governmental initiatives aimed at enhancing agricultural output in Africa, and particularly in Ghana, should be proportional to the area of land owned by farmers. This is to ensure that farmers operate within the economically viable range of farm sizes. Additionally, pre-harvest contracts designed to simulate market access have a negligible influence on agricultural productivity. This shows that measures targeted at increasing agricultural production should avoid focusing exclusively on pre-harvest market contracts, as this may result in a loss of productivity.

### Government Policy on Agricultural Credit

Education, caste, size, and occupation in the delta and non-delta portions of Andhra Pradesh's Nellore district [6].

Tuhin Narayan Roy (2017) attempted to quantitatively analyze the current state of agricultural loan availability to small and marginal farmers in

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India, as well as their performance under the priority lending sector policy (PSL) since 2001 [7]. The PSL program's purpose is to secure adequate credit for economically fragile sectors such as agriculture. In India, agricultural credit increased by 15.78 percent between FY10 and FY15. Despite numerous policy initiatives aimed at prioritizing impoverished farmers, little progress has been accomplished. Almost 51.9 percent of Indian farmers and 85 percent of marginal and small farmers are in debt, although they receive virtually little institutional financing (30 percent). Only 40% of the farmers have been issued with a Kishan Credit Card. The majority of PSL programs are interest rate-sensitive. According to RBI guideline, 40% of loans must go to the PSL sector, while 18% must go to agricultural. However, that figure drops to 13% by 2015. PSL coverage already exists as a result of improvements in standards and legislation. Direct agricultural loans to marginal farmers have decreased dramatically over the last decade, from nearly 23% in 2005 to just 4.3 percent in 2013. They control 85.03 percent of the total land area and 44.5 percent of the operating land area. However, the stock is presently trading at 7% and 8%, respectively. Agriculture production and credit levels in India have increased at a healthy rate. However, financing to farmers does not just stimulate agricultural credit growth, but also the agribusiness sector and agricultural-related businesses. Thus, agricultural credit delivery and access to impoverished farmers under the PSL have been insufficient. Experts emphasize the government's proactive involvement and recommend that PSL policies be designed and innovated efficiently. As a result, additional measures such as alternative livelihoods, poverty reduction, mainstreaming marginalized populations, and promotion of appropriate technologies/inputs for production, income, and quality of life of small and marginal farmers are advised.

In South Africa, as demonstrated by Joseph Chisasa and Daniel Makina (2015), there is a positive and significant link between bank lending, capital formation, and agricultural output [8]. The empirical findings of this study demonstrate that capital formation has a positive and significant effect on agricultural output in the short run. Thus, while credit may have a short-term negative effect on agricultural production, long-term adjustment processes have a quick positive effect. The Engle-Granger causality test reveals a positive relationship between (1) bank credit and agricultural output growth; (2) agricultural products and capital formation; (3) agricultural products for labor; (4) capital formation into credit; and (5) capital formation for labor, as well as bidirectional causality between credit and labor.

According to Swamy, Vighneswara (2010), equal growth is critical for inclusive growth, which in turn can result in sustainable growth. Poor people's

access to money is a necessary condition for poverty reduction and sustainable economic development. This study concluded that there is an urgent need to strengthen India's policy framework for financing the priority sector, since it has a favorable effect on inclusive growth. Given the substantial correlation between priority sector lending and inclusive growth, policymakers in general, and governments in particular, must make concerted efforts to encourage banks and financial institutions to lend to priority sectors above and beyond the required requirements. Priority sector lending in India has been significantly influenced by the lending approach taken by the Indian government. Priority sector loans in Indian banks have benefited inclusive growth over the course of the year. Given the strong correlation between priority and inclusive sector lending, policymakers in general and the government in particular must make a concerted effort to motivate banks and financial institutions to expand their priority sector lending beyond the Reserve Bank of India's prescribed limits and exponentially expand their businesses to reach priority sectors in order to achieve inclusive growth.

## Results and Discussion

### The Constraints of Agricultural Credit

According to an examination of various articles, the following describes farmers' difficulties in obtaining agricultural loans in detail:

1. Difficulty Compliance with the Requirements (Unbankable). To obtain credit from a financial institution or bank, the consumer must meet the common value criteria outlined in the 5C analysis. A person's character is defined as his or her temperament or personality; Capacity analysis is used to determine a customer's ability to repay credit; Capital is the state of wealth owned by a business controlled by a prospective debtor; Condition is an appraisal of the economic situation as viewed through the lens of prospective business prospects; and Collateral is a guarantee supplied by a prospective client, both physical and non-physical. However, farmers are still hampered in achieving the Bank's requirements (unbankable). As evidenced by studies conducted by Farida et al. (2014), the agriculture sector receives the least KUR. Because agriculture is a high-risk sector, formal banks avoid funding it for the following reasons: high transaction costs, asymmetric information, low returns, lack of collateral, low education, and low literacy.

2. Guarantee on loans with a low rate of return. This is because agriculture is viewed as a high-risk sector, and formal banks avoid funding it due to high transaction costs, asymmetric information, low earnings, a lack of collateral, low education, and low literacy. Banks generally avoid agriculture as a source of financing due to unpredictable supply and uncontrollable price risk. As Rahmatullah (2010) found, credit granting is still primarily handled by

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Central Government Banks, Regional Development Banks, and small lending banks, despite the fact that local banks are closer to the government and agricultural credit distribution remains small in comparison to other sectors [10]. Meanwhile, Darmawanto (2008) notes that while the Bank is always bound by applicable law when lending, there is a conflict of interests when it comes to credit distribution to the agricultural sector: on the one hand, the Government / Bank Indonesia seeks credit development in the agricultural sector, while on the other hand, it emphasizes the prudential principle in each disbursement with the risk of any credit degradation without special treatment [10].

3. Credit Market Collapse Farmers' bargaining power is often poor at the moment, which is one impediment to increasing farmer income. Farmers' weak bargaining position is partly attributable to the monopolistic market structure at the farm level. Within this structure, a few traders / wholesalers who control market access, market information, and capital adequately deal with a large number of farmers who lack market access, market information, and capital, leaving farmers in a position of lack of information and inability to meet credit requirements. As a result, farmers are less likely to benefit from government subsidies or low-interest loans. The trader is supposed to have complete control over the commodity sold by the farmer in this structure, yet the trader operates in a pure competitive market structure with the aggregate agricultural commodity market (the trader can not affect the aggregate market of agro-commodities, but only the transactions at the farm level). Additionally, to simplify the analysis, no marketing or processing charges are assumed, implying that the price at the trader is equivalent to the price in the market of production centers. Banks do not approve all household loan applications in rural areas, despite their willingness to pay higher interest rates (incomplete market). Due to the market's inadequacy, farmers borrow funds through informal financial institutions, often at exorbitant interest rates. This is corroborated by Minh Chau Tran's (2016) study, which found that when informal credit provides a sufficient supplement to formal credit, informal credit plays an active role in raising household income that is controlled by credit. This per capita consumption indicator demonstrates that credit-constrained families can increase their per capita consumption by obtaining sufficient credit from informal sources.

4. Distinct Treatment When It Comes to Credit. According to Farida et al. (2014), there are a number of factors that might greatly impact people's access to business loan programs. This includes gender, business tenure, impediments to business, bank accounts, spousal employment, and other sources of lending. According to the odds ratio, men were 6.56

times more likely than women to have access to credit. Individuals with bank accounts have a 3.66-fold increased likelihood of obtaining credit. KUR is frequently accessed by new ventures with limited funding and those whose partners labor. Gender is a significant factor in determining access to KUR in home micro enterprises, with men having a greater likelihood of accessing KUR than women. Property and property ownership in the husband's name minimize the involvement of the wife in obtaining a loan. Women have minimal involvement with formal institutions and sign loan contracts as a result of their lack of expertise or education level. While Minh Chau Tran's (2016) research demonstrates that families headed by females that are young and undereducated are under-financed by formal financial institutions. Likewise, the size of agricultural land, labor resources, and non-agricultural income all contribute significantly to the reduction of household credit limits.

### Conclusion

Credit restrictions on agriculture as a high-risk enterprise mean that formal institutions are less interested in funding it on the basis of high transaction costs, asymmetric information, limited profitability, a lack of collateral, and farmers' education levels are generally low. Additionally, due to unpredictable production and uncontrolled pricing risk, the majority of banks are unable to finance agriculture. While the farmers' constraints in obtaining formal loans are complex, they should include collateral, expensive payment delay fees, extensive distances, and a lack of information regarding capital.

Government policy on agricultural loans is an inclusive strategy. Finance is a national development strategy that aims to stimulate economic growth by promoting income equality, poverty reduction, and financial system stability. This community-based plan must target groups that have challenges to financial services access. The inclusive financial strategy specifically targets the groups with the highest or unmet financial service needs, namely the three categories of individuals (the poor, low-income, working poor/poor, and near-poor) and three cross-categories (migrant workers, women and the population underdeveloped regions). Coordination between Bank Indonesia and relevant ministries and institutions is essential to plan, prioritize, and implement the program, as well as to monitor and evaluate the program. With proper coordination, the goal of community access to financial services should be achievable. One of the inclusive financial programs required to satisfy farmers' financing needs for farming sustainability and household needs is low-interest agricultural loans, such as KUR, and farmers' development from unbankable to bankable status.

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