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Credit for Rural Poor in Pakistan

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1. INTRODUCTION

Farmers, large and small, and the non-farm population in rural areas all suffer from the liquidity constraint. Credit is needed to acquire command over the use of working capital, fixed capital, and consumption goods. The Green Revolution technologies have increased the credit requirement for modern inputs and farm investment. A new expanded role of rural credit institutions has emerged in the wake of the technology revolution in rural areas.

Two distinct approaches have been used to provide the financial services to the rural poor. The most widely favoured approach in the past was the use of subsidised interest rates with a portion of credit reserved for the poor. The low interest policy was based on the premise that it would induce farmers, large and small, to use modern inputs on a larger scale. One of the adverse side-effect of this policy was the introduction of an element of financial unsustainability in the loan portfolios of the credit institutions. The recent view about the delivery of rural credit consists of using market interest rates and using a mixture of 'bottom-up initiatives' at the local level, using non-government groups and 'top-down initiatives' by the formal credit institutions in terms of the simplification of the procedures and decentralisation of the credit operation for credit supply to the rural poor. In this paper, an attempt is made to evaluate the efficacy of these two approaches in the case of Pakistan for delivering credit to the rural poor.

2. INSTITUTIONAL CREDIT REFORM: A BRIEF DESCRIPTION

The policy approach to the provision of rural credit in Pakistan has evolved in a gradual manner since independence in 1947 in response to the changing perception of the role of rural credit [Qureshi (1992)]. The policy thrust to provide low-interest loans was implemented through the establishment of a variety of credit institutions to cater to specific credit needs of the rural population.

Prior to 1947, institutional credit was mainly provided as *taccavi* loans by the government, and as cooperative credit by the cooperative societies in rural areas. The cooperative credit in the subcontinent has a long and somewhat chequered history.

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To begin with, it had no formal relationship with the financing of inputs and/or farm investments. It was designed to compete with non-institutional sources of credit and was aimed generally at meeting the credit needs of farmers for consumption smoothing. With the establishment of a Federal Bank for Cooperatives in 1976, which was provided with large and cheap financial support from the State Bank of Pakistan and the induction of commercial banks in agricultural lending in 1972, the philosophy behind both the cooperative credit and the commercial credit underwent a fundamental change. Mandatory credit targets for small farmers were fixed for the commercial banks.[1] An institutional mechanism for monitoring these credit targets was also prescribed. The non-observance of these targets by the banks involved the payment of a penalty by the banks to the State Bank of Pakistan.

In addition to a re-vitalisation of the cooperative credit system and the introduction of commercial banks to agricultural lending, the mandate of the Agricultural Development Bank of Pakistan (ADBP), established in 1961, was also changed to cater to the credit needs of small farmers and the non-farm sector in rural areas. The ADBP has five loan windows, i.e., Development Loans, Production Loans, Agri-business Loans, Cottage Industry Loans, and Off-farm Income Generating Activity Loans. The ADBP was also persuaded by the government to evolve numerous special credit schemes to improve the access of special groups to credit. In 1979, a new credit delivery system, i.e., the Supervised Agricultural Credit System (SACS) was introduced to reach the small farmers. This system was intended to reduce the transaction costs of borrowers ADBP's village-based banking approach, through the Mobile Credit Officers (MCOs), was also instrumental in bridging the technology gap between the small and large farmers. The procedural shift towards project-oriented loaning, instead of the security-oriented loaning, was intended to increase the access of the poor to credit. The decentralisation of the credit operation of the ADBP was intended to deliver the credit in rural areas at the lowest possible cost to its borrowers.

To further strengthen the system of MCOs, a cadre of Functional Mobile Credit Officers (FMCOs) was also evolved by the ADBP. The FMCOs are subject specialists in the fields of dairy, poultry, irrigation, fruits and vegetables. The FMCOs serve as agents of change for cross-pollination of relevant information about technology and the soil conditions in different locations and credit use.

Some specific measures were also taken to diversify the loan portfolio of the Bank with the help of new schemes and with the objective of increasing the scope

[1]The mandatory targets fixed were that 70 percent of institutional loans must be advanced to farms of less than 12.5 acres, 20 percent to farms between 12.5 acres and 50 acres, and 10 percent to farms larger than 50 acres. Initially, these targets were in respect of small loans. In 1980-81, the entire amount of credit to be provided by commercial banks to the agricultural sector was to be treated as a mandatory target.

and coverage of small farmers particularly in *barani* areas and other agriculturally backward areas. Loans under these special schemes were advanced for area-specific activities. Important and interesting experiments under this scheme include the Gujranwala Agricultural Development Project (GADP), the Rural Credit Programme, the National Oilseed Development Project, the Participatory Rural Development Project, the Private Tubewell Development Project, the Sindh Forestry Development Project, the Small Holder Dairy Development Project, the Second Barani Area Development Project, the Second SCARP Transition Project, the NWFP Barani Area Development Project, and the Mansehra Village Support Programme.

The rural credit institutions, described above, rely on different sources of funds. The commercial banks depend entirely on the deposit mobilisation. All other institutions, though not barred from deposit mobilisation, have depended in the past on refinancing from the State Bank of Pakistan and/or foreign financial institutions. The ADBP has borrowed extensively from the World Bank, the Asian Development Bank, the International Fund for Agricultural Development, and the State Bank of Pakistan. The Federal Bank for Cooperatives has depended exclusively on the State Bank of Pakistan. Strict upper limits on the rate of interest on deposits of different kinds and the availability of financial instruments offering high returns, like Defense Savings Certificates, explain poor deposit mobilisation by commercial banks in the past. The availability of cheap refinancing facilities from the State Bank of Pakistan had discouraged the Cooperative Societies and the ADBP in their efforts to mobilise deposits from their clients.

The policy of the State Bank to provide low-cost funds to financial institutions for on-lending to farmers was based on the role that subsidised credit could play in increasing agricultural production. The subsidy on the agricultural loans was aimed at lowering the cost of inputs and farm investment, to enable farmers to adopt modern inputs and purchase farm machinery. The top-down approach comprising the provision of subsidised rural credit, with a fixed quota for small farms, and its delivery at the village level were the main policy parameters of the formal rural credit system in Pakistan.

3. CHANGES IN ACCESS OF THE POOR TO RURAL CREDIT

Policy steps taken by the government to increase the share of small farmers in institutional credit were briefly described in the previous section. We now attempt to measure the extent to which government succeeded in its effort and identify the factors that may have impeded the implementation of the credit programmes. Data on the number of recipients of institutional credit are extremely scanty. Information about various facets of the credit market from two large surveys for 1973 and 1985 is used to delineate the changes in trends in the access to credit over time. Detailed analysis for 1973 is presented in Qureshi *et al.* (1984) and for 1985 in Malik *et al.* (1989). The government operationalised its policy objectives in the field of rural credit in terms of three indices. First, the government had stipulated that a specified proportion of production credit should flow to farmers below a certain size of farms. Second, the proportion of farmers to be brought under the purview of institutional credit should be increasing through time. Third, the institutional credit should gradually replace the non-institutional sources of credit in rural areas.

Table 1 shows different patterns of credit use and economic characteristics by size of farms for cultivator households. Average inequality in the distribution of credit measured by the Gini coefficient increases between 1973 and 1985. However, the share of the small farmers in institutional credit increases over time. In both years, the extent of average inequality is high relative to the inequality in distribution of operated area. Most importantly, it should be noted that the share of institutional credit going to small, medium, and large farms in each of the two years diverges sharply from the shares prescribed by the government. Small and medium farmers get much less credit than is prescribed for them according to government rules..

The distribution of credit is decomposed in two measures of (i) proportion of households with access to credit and (ii) average borrowings per borrowing household, in Rows 2 and 3 respectively. The credit widening is measured by the proportion of farms with access to institutional credit. It is interesting to note that despite an impressive rate of increase in institutional credit between 1973 and 1985, the proportion of cultivators with access to such credit increases from 1.98 percent in 1973 to only 5.95 percent in 1985. The credit widening is, however, related positively with the size of farm in each of the two years under study. The average inequality in access to credit is high for each year and has risen between the two years. The small farmers have also experienced an increase in access to institutional credit between the two years. The magnitude of increase in access to credit is, however, much larger for large than small farmers

The credit deepening measured by the amount of credit per borrower is shown in Row 3. The average inequality is high for each year and it increases sharply between 1973 and 1985. The credit deepening increases with the size of farm. Between years, the credit deepening has also increased sharply. In nominal terms, the amount of borrowings per borrower increases from Rs 3220 in 1973 to Rs 23012 in 1985. Row 4 of Table 1 presents information on the importance of institutional sources in total credit for 1973 and 1985. Despite an increasing importance of the institutional credit, the non-institutional credit is still the dominant source of credit, as institutional credit in 1985 is only 31 percent of the total credit availed of by the cultivators. The importance of the institutional sources of credit, however, increases with the size of farm, as the larger the farm, the more important is the share of institutional sources in total credit.

Table 1

Profile of Economic Characteristics and Credit Use by Cultivator Households

	Size of Farms (Acres)													
	0–5		5–15		15–25		25–50		50		All Sizes		Gini Coefficient	
	1973	1985	1973	1985	1973	1985	1973	1985	1973	1985	1973	1985	1973	1985
1. Distribution of Institutional Loans Obtained (%)	2.60	4.99	28.36	22.61	10.26	17.80	17.41	27.50	41.37	27.10	100	100	0.327	0.342
2. Proportion of Farms Obtaining Institutional Loans (%)	0.98	1.74	1.55	5.94	2.60	10.19	3.42	17.35	7.93	24.68	1.98	5.95	0.327	0.443
3. Distribution of Average Institutional Borrowing per Borrowing Household (Rs)	672	10301	2424	12526	1812	20171	3768	37170	7947	62516	3220	23012	0.450	0.692
4. Distribution of Institutional Loans as Percentage of All Loans (%)	1.48	7.45	6.88	21.81	6.40	33.63	13.38	51.82	29.00	61.31	9.80	31.16	–	–
5. Percentage of Farms	25.18	38.21	48.18	41.65	13.85	11.88	8.61	5.85	4.18	2.41	100	100	–	–
6. Percentage of Production	6.03	–	36.87	–	18.17	–	15.60	–	22.42	–	100	–	–	–
7. Percentage of Operated Area	4.48	–	29.90	–	17.45	–	18.81	–	29.36	–	100	–	–	–

Source: Qureshi and Shah (1992).

Note: – Indicates 'not computed' due to non-availability of data.

Rows 5, 6, and 7 present three farm size dimensions for 1973, and one for 1985. These dimensions are (1) percent of farm numbers; (2) percent of production; and (3) percent of operated area. Comparing the shares in the credit reported in Row 1, with each type of farm-size dimension, one can evaluate the extent to which, on the country-wide basis, the objectives of increased and equitable distribution of institutional credit have been achieved. The comparison shows a failure to achieve the objective of an equitable distribution of credit when equity outcome is judged according to either of the three criteria, as the share of the small farms in institutional credit is less than their share in production, or operated area or farm area.

The reasons for small farmers in obtaining credit less than the mandated targets for them are embedded in the faulty design of government policies. Funds earmarked for such agricultural loans have always been limited and subsidised. The credit rationing always results in the credit going to the large influential landowners who can afford to collude with bank officials. Like many other countries, the social and political power within rural Pakistan has followed the pattern of the distribution of land, which is highly uneven in Pakistan. The cost to commercial banks of servicing small farmers is higher than for large farmers. This provides an incentive to banks to lend primarily to large farmers. It is not surprising, therefore, that the large farmers and the bank officials have colluded to exclude the eligible small borrowers from their prescribed share in institutional credit. The collusion between large farmers and the bank officials had not only deprived the small farmers of their due share in credit, it had also resulted in high rates of default by the borrowers. The information on default rates is not easily available. However, the limited scattered information is indicative of high default rates, especially by the large farms.

According to the unpublished information for 1989-90 from the Agricultural Credit Department, State Bank of Pakistan, the recovery rate for commercial banks and the ADBP was 35.5 percent and 42 percent respectively. The recovery rate for the ADBP has improved somewhat for later years, but for the year 1995-96, the cumulated recovery rate still stands at 86 percent. In the case of the borrowers of the ADBP, the recovery rate for the subsistence holdings, economic holdings, and large holdings was 45.3 percent, 46.3 percent, and 28 percent, respectively. Since the external adverse natural conditions should be the same for holdings of different sizes in any one year, it seems that the large holdings are defaulting wilfully to a higher extent than the small and medium holdings.

4. NON-GOVERNMENT ORGANISATIONS FOR DELIVERY OF CREDIT TO THE RURAL POOR

The limited success of formal institutional credit in reaching rural poor stems from a view held by the bank officials that the poor are not credit-worthy. Access of the poor to credit remains limited as they lack the assets and skills to obtain and use the credit productively. This view has been challenged by lessons learnt from many pilot projects that have organised the poor and have used groups to promote savings and individual borrowings by using group guarantees as a collateral for loans. Credit intervention has been only one component of a comprehensive technical and institutional rural development package in these pilot projects.

The Aga Khan Rural Support Programme (AKRSP) was initiated in 1982 for the purpose of implementing a rural development programme in the Northern Areas of Pakistan. The essential elements of the AKRSP are the establishment of effective Village Organisations (VOs). Each VO starts its operation with one grant-assisted productive physical infrastructure project. The women's VOs focus on various aspects of raising women's productivity and welfare. Examples of the activities in which these organisations are engaged are: (i) introduction and dissemination of improved varieties and cultivation techniques for crops; (ii) improved livestock husbandry practices; and (iii) new productivity-raising technology for apricot-drying tents, nut-cracking machines, and butter-churners. AKRSP helps the village organisations to obtain access to institutional credit by acting as a loan guarantor through the promotion of savings by members, which serve both as a form of loan collateral for credit and provide supportive marketing services for different products.

The savings and credit programme of the AKRSP is based on a system of collective savings and borrowings. Each member deposits his/her savings with the Manager of the village organisation. The collective savings of the Village Organisation are deposited in a single account held at a commercial bank. Credit facilities are extended in a similar manner. The village organisation takes out a single collective loan and disburses sub-loans to members according to individual's credit need. This system minimises the transaction costs for borrowers in both savings and borrowings. Due to the peer group pressure, the transparent nature of the credit operations, and the group guarantees for loans, the repayment rates for loans are almost 100 percent. The employment and income impact, especially for the poor, has been quite substantial.

Based on substantial positive results from group-based savings mobilisations and credit programmes by the AKRSP, a National Rural Support Programme (NRSP) was started in 1991 and expanded in 1992 with a grant from the Government of Pakistan. NRSP is building a network of grassroots organisations which plan and undertake their own development. It uses a development strategy which mobilises communities and maximises the use of local resources. NRSP is a support organisation dedicated to promoting participatory development in rural Pakistan. It is based on the tried and tested methodology of development programmes such as the Aga Khan Rural Support Programme (AKRSP) and the Orangi Pilot Project (OPP). The evaluations of the AKRSP and OPP show that the poor have been successfully helped by the credit and other related interventions in a financially sustainable manner.

5. CONCLUSIONS

Over the last thirty years, Pakistan's subsidised supply-led approach to increasing rural credit for the poor has had limited success. Mainly due to limited access to institutional credit, the impact of the credit on the small farmers has been much below the policy-makers' intention. Small farmers, by definition, had faced a handicap as they had limited access to land and were placed at the bottom of the social and economic power matrix. The schemes introduced by the ADBP to provide for the specific needs of small farmers in remote areas were not backed by financial and/or staff resources to make any substantial contribution. Despite the introduction of mobile credit officers, the administrative cost of the credit delivered by the ADBP was quite high. The borrowers also had to incur large amounts of expenses to access the credit as the procedures remained cumbersome.

The success attained by the AKRSP in improving the living conditions from the adoption of a comprehensive rural development programme, and its subsequent replication in the Balochistan Rural Support Programme, the National Rural Support Programme, and the Sarhad Rural Support Corporation, augurs well for the rural poor in Pakistan. The success in the replicability of the AKRSP on a larger scale is, however, not certain yet. The replicability of the programme in other parts of Pakistan is likely to be affected by particular characteristics of the Northern Areas of Pakistan, programme's management structure, or the scale of resources made available to the AKRSP. The strategy of the Programme and the flexible approach adopted in organising the village people, in the village and women's organisations, and their willing partnership with the management of the AKRSP in the implementation of the Programme in Northern Areas should make it suitable for replication in other parts of Pakistan.

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Comments

The topic of the paper is timely. It addresses an issue which is pivotal to the efforts in maximising the gains reposed in the agricultural/rural sector of the economy.

However, the importance of the issue addressed in the paper requires that it focus on the following aspects of the problem as well in order to present more meaningfully the suggested "Group-Based" lending of rural credit:

(i) Political Economy of Rural Credit;
(ii) Role of Non-Institutional Sources of Credit; and
(iii) Problems in Adapting NGO's Programme.

(i) Political Economy of Rural Credit

The paper does not highlight the prevalent agrarian structure in the plains of Pakistan, particularly in the provinces of Punjab and Sindh, where over 95 percent of institutional credit is advanced. The paper does reflect failures of institutional sources in meeting the targets to cover small farmers. However, it does not go beyond that by presenting an analysis as to why these institutions failed. Whereas it is true that differentials in the rates of interest and increased transaction costs (largely due to smaller credit network) have appeared as constraints in developing rural financial markets in the country, it is equally important to highlight the constraints imposed by the political and feudal structure impeding the emergence of rural financial markets.

Though the institutional sources of credit have expanded their activities by accounting for 10 percent of total credit supply in agriculture in 1973 to 31 percent in 1985, the mere fact that these institutions have failed to cover small farmers as per policy, plus the growing concerns over huge defaults, raise doubts whether in real terms the institutional sources account for over 30 percent of the total credit supplies.

(ii) Role of Non-institutional Sources of Rural Credit

Although the paper focuses on institutional sources of rural credit and attempts to suggest "Group-Based" lending, it seems relevant to discuss at length the role of non-institutional sources. How have these continued to dominate the rural credit supplies in Pakistan? What are the sources of income of these informal markets? To what extent do the large farmers play a role in the functioning of such markets? These are some of the basic questions which need some explanation before any suggestion for modification or adjustment in the existing system of rural credit is made, or any adaptation of a successful programme is recommended.

(iii) Problems in Adapting NGO's Programme

In the absence of the information detailed above, the paper seems to have jumped to suggest the adaptation of the AKRSP approach towards village-level banking. It would also be interesting in this regard to look into the successes and failures of Grameen Bank.

The Northern Areas of Pakistan, in their agrarian set-up, have an egalitarian system of distribution which is quite contrary to what we observe in the plains of the Indus Basin .

In addition, the whole package including the establishment of village organisations, mobilisation of household savings, provision of physical infra-structure (through the Programme's grant and villagers' subsidies), effective participation by women, and the extension services given by AKRSP served as contributing factors in successfully establishing village-level banking. None of the components of this package was ever actively pursued in the plains.

Since the agrarian structure in the NWFP and Balochistan is more egalitarian in relation to that in the Punjab and Sindh, it would have been more relevant to make adaptations of the AKRSP in these places, although it will take some time to evaluate the performance of the SRSC and BRSP. Attempts to make similar adaptations in the Punjab and Sindh would require certain pre-conditions to create a congenial environment which is conducive to an egalitarian system. On the contrary, the fate of such attempts would not be any different from that of institutional sources in extending rural credit.

On the whole, the paper is a good attempt in highlighting the obtaining situation regarding rural credit supplies. The further research agenda on the topic would require further analysis of the failures of institutional credit in raising the productivity level in agriculture and in improving income inequalities of the rural poors in Pakistan.

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