AGRICULTURAL CREDIT MARKETS IN NORTHWEST PAKISTAN: IMPLICATIONS FOR THE DEVELOPMENT POLICY

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ABSTRACT

This study was carried out in 2005-06 in district Peshawar, Khyber Pakhtunkhwa with the aim to investigate agricultural and non-agricultural credit markets. The study found that farmers in the area benefited from both agricultural and non-agricultural credit markets. However, access to formal credit institutions was not possible for all farmers. Despite farmers’ inability to furnish land documents as collateral, a number of other difficulties, such as cumbersome loaning procedure and rigid repayment conditions, were noted as main barriers to attaining credit from the formal institutions. The potential expansion of social polarization in the wake of unfair access to agricultural credit was thereby curtailed by the non-agricultural credit markets. The study also depicted that agricultural credit was mainly utilized at farm and non-agricultural credit was used off-farm for social festivities. It is concluded that there is a need to reformulate the development policy. The new policy must take into account all possible accessibility measures to the agricultural credit markets. At the same time, it should institutionalize non-agricultural credit markets to reduce social polarity so that all prospective farmers take benefits from both the credit sources.

Key Words: Agricultural credit, non-agricultural credit, collateral, smallholders, social polarization.

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INTRODUCTION

The developing countries are often experiencing high population growth. There is a worldwide need to increase agricultural productivity so that to ensure food security for the growing populations (Manig, 1990). Developed countries experienced increased farm productivity due to modern technological innovations. But this has been a challenge for the developing countries where smallholders and landless peasants do not have adequate financial resources to use modern inputs and technology. Availability of financial capital is, hence seen as an important pre-requisite for adopting modern technology (Jan et al., 2008; Jan and Khan, 2012). To some extent, this problem is solved by the non-institutional credit markets in the developing countries which play an important role in their agricultural and socioeconomic development (Okurut et al., 2005).

There exist two types of agricultural credit markets in most of the developing countries viz. agricultural and non-agricultural credit markets. The terms agricultural credit or formal credit and non-agricultural credit or informal credit are used synonymously in this paper. Formal credit markets include agricultural banks, commercial banks, and micro-finance institutions (MFIs). The MFIs include credit unions and cooperatives, group-based programme supported by government agencies or non-governmental organizations, village banks, and financial service associations. The relationships between lenders and borrowers in formal credit system are totally based on commercial ties. The rest of the credit relationships are within the informal sector (Zeller and Sharma, 1998). The non-institutional sources are professional money lenders, friends, relatives, neighbours, and commission agents (Jan, 2007). The credit relation in the informal markets is based on the social ties rather than economic. Despite the fact that informal credit sources are important in meeting the financial demands of the farmers in difficult times, yet most part of this credit goes into non-productive activities.
In Pakistan there are two major sources of agricultural finance i.e. institutional sources and non-institutional sources. The institutional sources are Zarai Taraqiati Bank Limited (ZTBL), Commercial Banks, Cooperatives and Domestic Private Banking. The share of the commercial banks in agricultural credit disbursement is increasing day by day and they are the second largest contributors followed by ZTBL (Iqbal et al., 2003). While adopting similar mechanism for credit disbursement, the credit schemes of cooperatives vary little from those of ZTBL and other banks in terms of the credit ceiling and the security requirements (Jan, 2007). Like other developing countries, friends, relative, neighbors, private money lenders, and commission agents are the main sources of informal credit (Jan et al., 2011). These credit sources are playing their role in bridging the social differentials in the society. In order to reduce the possibilities of expanding social polarization due to inequitable access to formal credit markets and inability of the poor to adopt modern technology or celebrate social event, the informal credit markets play their role by overcoming financial needs of the poor farmers (Manig, 1990). The credit relations in informal credit markets portray a visible element of the social and personalized system of human interaction. The purpose of this is to support activities of others, which is a part of their existing predominant social inter-relationships.

Agricultural credit may benefit farmers on a large scale if all categories of prospective farmers procure credit. The issues of procurement are severe in case of smallholders and peasants. Despite recent reforms in the financial sector in Pakistan, still less than 10% of rural population have access to sufficient and inexpensive credit services (Jan et al., 2011; Jan and Manig, 2008). They come across a number of limitations while approaching to the formal lending institutions for getting credit. The pre-conditions of the formal agricultural financial institutions, such as provision of land documents as collateral, restrict poor to procure credit from those institutions. In addition, the distribution of the institutional credit is based on socio-political influences of various social groups. Thus, more influential farmers get more benefits from the credit programs than others (Manig, 1990; Jan et al., 2011). Subsequently, large proportion of the smallholders and landless peasants, who are more credit worthy and having desire to apply new technological innovations and celebrate social events turn to the non-institutional credit sources. The poor easily access the informal credit markets such as friends, relatives, neighbours, commission agents or professional moneylenders. These lenders advance small amounts for short periods. According to Zeller and Sharma (1998), “these informal networks are frequently successful in tiding the poor over difficult times and they enable poor households to build up savings for investments that can help lift them out of poverty”.

Justification of the Study

As mentioned earlier, farmers in Pakistan attain low yield per unit area due to a number of factors. One of the most important of these factors is unavailability of financial resources to the farmers. To compensate for the problem, the government of Pakistan has introduced agricultural credit schemes throughout the country. The major institution providing agricultural credit to farmers is Zarai Taraqiati Bank Limited (ZTBL). On the directives of the State Bank of Pakistan, all commercial banks in Pakistan have also initiated agricultural credit programs for farmers. The farmers, however, face two major problems in attaining agricultural credit from the formal lending institutions. Firstly, the credit services are not enough to meet requirement of farmers as a whole. Secondly, the security restrictions of the formal credit institutions are tough enough that most of the farmers fail to fulfil. Since large proportion of farmers in Pakistan is either smallholders or landless peasants, they remain un-benefited from these schemes. Consequently, they approach informal credit markets to meet their financial requirements. This paper looks into farmers’ procurement of credit from various sources and utilization of this credit for different on and off-farm purposes. The paper further identifies difficulties to adopting formal credit and the reasons behind a farmer choice of a particular source of credit.

Research Question and Hypothesis

The research is guided by the general question: what is the role of agricultural credit on overall development of the farmers? Before getting empirical evidence for getting answer to this question, it is
hypothesized that formal and informal credit markets are playing important role in agricultural and socioeconomic development of the farmers.

MATERIAL AND METHODS

Survey Design and Data

This study is a part of the PhD study by the principal author which was carried out in District Peshawar in Khyber Pakhtunkhwa. The villages selected for the study were Dalazak, Gulbela, Kochian, Kukar, Mushtarzai and Yousaf Khel. These villages are located close to Peshawar and represent heterogeneous social, economic, political, and cultural characteristics. The data was primarily collected through interviews using a semi-structured questionnaire. The unit of analysis for the study was a household, which is defined as “a group of persons who normally live and eat together in the same dwelling” (Chianu and Tsujii, 2004). The farm households in the village were further categorized based on landholding and employment structures. For study to be least biased, sample from all villages was made proportionately and randomly from all farming categories. The overall sample size comprised of 120 households.

Analytical Technique

The data collected was analysed using SPSS. Descriptive statistics technique was used to analyse the data. The detailed description of the results is provided in subsequent sections.

RESULTS AND DISCUSSIONS

Credit Sources in the Area

As mentioned earlier, both formal and informal credit markets prevailed in the study region. The (Fig. 1) shows that 49% of the farmers’ attained credit from non-institutional sources. A minor proportion of the farmers (i.e. 13%) obtained credit from the institutional sources. The remaining 38% households did not participate in any credit program at all. This means that out of the total credit procuring households, 21% got it from formal sources whereas 79% procured it from informal sources.

![Credit Sources Pie Chart]

Source: Own Field Data

Fig 1. Delineation of the important credit sources in the area

Furthermore, the informal credit sources have been sub-categorized. The sample respondent recorded that they benefited from friends, relatives, private money lenders, and commission agents. Due to some indirect economic ties involved in case of the private money lenders and commission agents, these sources are not popular anymore amongst the borrowers. Friends and relatives, however, are the most
popular, reliable, and easily accessible sources of informal credit. The credit relations in informal sources are mostly based on the values of reciprocity and mutual help which is one of the core elements of the social life of the Pathans.

**Credit Procurement by Amount**

The principal financing agency for agricultural development in Pakistan is the country’s only bank for agricultural credit – the Zarai Taraqiati Bank Limited (ZTBL). Besides, other commercial banks also extend credit services to the farmers through their special credit programmes. The major problem in accessing agricultural credit services is the fulfillment of cumbersome and lengthy pre-conditions of the formal lending institutions. This is why farmers in the area often do not fully benefit from agricultural credit markets, despite they explicitly need it. (Fig. 2) delineates the agricultural credit distribution in the area. The figure unequivocally demonstrates that major portion of the credit transactions occurred in small amount. It was found that 75% of these transactions fluctuated between 1000 and 150,000 Pakistani Rupees (PKR). The remaining 25% transactions ranged in amount more than 150,000 PKR.

It can be drawn from the field survey that villages with owner-operator tenancy system exhibited large number of credit contracts. Nevertheless, these transactions were in small amount. On contrarily, lower numbers of credit transactions but in higher amount were noted in the villages where exclusively landlord-tenant system existed. This is mainly because size of landholding and political power are the major determinants of acquiring credit from the institutional sources. Using their political influence, the landlords procured large amount from these institutions. Due to inability of the small farmers to fulfill the security requirements of these institutions, the credit worthy smallholders and landless peasants who wish to finance inputs and technology fail to do it.

![Credit Distribution Chart](image)

**Fig 2. Distribution of formal credit by amount in the area**

Similarly, (Fig. 3) demarcates the dissemination of non-institutional credit in the selected villages. It is clear from the figure that as large as 81% of the credit transactions were in small amount ranging from 1000 to 50,000 PKR. The remaining 19% credit transactions were in higher amount (more than 50,000 PKR). It is important to mention that informal credit sources were largely functional in traditional villages compared to more or less modernized ones. Since informal credit is mostly attained in emergency for financing festivities (Fig. 4), small amount of credit is taken at the time of need.
Like different requirements and pre-conditions for different sources of credit, the purposes of utilization of credit from different sources also differ. The purposes for which informal credit is utilized in the area are delineated in (Fig. 4). The figure clearly demonstrates that informal credit is mostly used (22%) for different social activities like festivals and ceremonies. Social status is an eminent component of village life of Pathans and they make every possible effort to maintain it through celebrating social festivities in the village with great zeal. In case of unavailability of finances at the time of festivities, they acquire credit; particularly from the informal sources to finances such social events.

Likewise, medical expenses and other off-farm investments are also met through financing from informal credit sources, as clear from (Fig. 4). Most part of the off-farm investment is spent visa and ticket arrangements for the household member going abroad, particularly to Gulf countries. The figure also shows that 13% of the informal credit was used for purchase of inputs which means that those farmers who cannot benefit from formal credit sources turn to informal sources at the start of the growing season. Similarly, 8% of the credit was utilized for purchase of livestock and domestic consumption. Looking at the overall
The importance of credit as an effective instrument for agricultural development is recognized worldwide. In past agricultural credit programmes have played their role in increasing farm production (Richard, 1990; Malik et al., 1991; Khandker and Faruqee, 2003; Khan et al., 2008). The encouraging results of the agricultural credit can be achieved only if it is properly utilized at farm. The different purposes for which institutional credit is utilized are listed and displayed in (Fig. 5). It is encouraging to note that institutional credit is mostly used for productive purposes at farm. More than 50% of the formal credit is used for financing variable inputs and farm machinery. The rest of the formal credit is used for other farm purposes (irrigation channels, dairy etc.) and in the household for off-farm purposes. The contemporary literature provides a number of evidences that agricultural credit has contributed to the purchase of inputs and technology. For example, Zuberi (1989) found that formal credit is an important cause of fertilizer and seed expenditure. Similarly, the study of von Braun et al., (1993) records that farmers having access to credit have 37% higher input expenditures than those who do not have access to credit.

**Difficulties in Procuring Formal Credit**

Although the institutional credit programs have been expanded in Pakistan in the recent past, yet major portion of the deserving farmers cannot attain credit from these programs. They confront with a number of difficulties in approaching to these lending institutions. What difficulties did the farmers face in attaining formal credit? The farmers’ response to this question is summarized in (Fig. 6). Most of the farmers noted that the cumbersome qualifying process was the main hurdle in attaining formal credit. The figure also clearly outlines that 94% of farmers were not satisfied with the pre-conditions of the agricultural credit institutions. To provide requisite documentary proofs for demonstrating as a genuine borrower, the farmers have to pay many visits to Peshawar to manage land documents (known as passbook). For instance, the provision of land papers which are used as collateral is a clumsy job to get. The farmers often decline to apply for the credit because of the high transaction costs involved in qualifying procedure. Another point of dislike, as mentioned by a number of farmers was the high mark-up rates. Similarly, farmers were also not happy with the strict repayment terms and unfavorable demands of the bank staff. Failure of the applicant to meet the bribery demands by the bank staff, sometimes leads to rejection of the application of a
potential borrower. In the wake of such limitations, sometimes potential borrowers turn to informal credit sources instead of the formal counterparts.

![Graph showing difficulty in attaining formal credit](image)

Source: Own Field Data

**Fig 6. Percent distribution of farmers facing various difficulties in attaining formal credit**

### Reasons for Preferring a Particular Source of Credit

Rural people have specific preferences for selecting a credit source and have various justifications for that. Sometimes, their justification is based on their own perception or on their past experience. The sample farmers in the area noted different reasons for preferring formal and informal credit markets. (Fig. 7) outlines that 49% of the respondents preferred institutional credit for no fear of any time repayment demand. Since the repayment time is pre-determined, they are relaxed and plan accordingly. In case of informal credits, however, the likelihood is there that the lender can ask for repayment anytime. This is against the egoistic nature of the Pathans tribe, and hence they prefer formal credit sources. Another point of liking for institutional credit sources was the disbursement of a hand sum amount, which was recorded by 27% of the farmers. Likewise, 24% were of the opinion that formal credit sources were reliable as in other case, they had to ask from their community fellows, which was a threat to their status and self-esteem.

The figure also discloses three reasons based on which farmers liked informal credit sources. The figure shows that 44% of the respondents preferred informal credit because of its timely and easily availability. An important characteristic of the informal credit is that they are mostly mark-up free, particularly if acquired from friends and relatives, for which 39% farmers opted. Similarly, some farmers also liked informal credit for no pre-conditions such as land or personal security.
CONCLUSION

Like other developing countries, both agricultural (institutional) and non-agricultural (non-institutional) credit markets existed in the rural northwest Pakistan. However, farmers’ accessibility to institutional credit sources was a problem. Multiple factors such as security requirements of the formal lending institutions and lengthy procedure to qualify for credit were contributing to farmers’ lack of accessibility to the institutional credit sources. For a large number of small farmers, it was a challenging issue to meet all the security pre-conditions of these institutions. Hence, these farmers who wished to procure modern inputs and technology failed to benefit from credit programs of the institutional sources. Consequently, small farmers turn to the easily accessible informal credit markets. This study also finds that institutional credit is mostly used for farm purposes, whereas non-institutional credit is used for off-farm purposes such as organizing social festivities. Both of these events (improved farm production and celebrating festivities) are important components of life of the Pathans. Thus inability of the farmers to benefit from the institutional credit sources is overcome by non-institutional credit sources. This is important for reducing social polarity in rural system. It is needed from the policy perspectives that the formal lending institutions need to revise and relax their credit delivery mechanism which is accessible and affordable to smallholders and landless farmers. Simultaneously, there is a need to reinforce the informal credit system as a political measure to reduce social polarization in traditional village system. This in turn will contribute to a planned institutional change in traditional agrarian societies such as the research area.

REFERENCES


