

PAPER 2

Smallholder Access to Credit

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The context

As observed by the Planning Commission (2009) adequate availability of credit to all farmers is a precondition for the increased use of modern inputs such as fertilisers, improved varieties of seed and modern technologies. However, in reality most credit surveys show that farmers remain credit-constrained. State Bank of Pakistan (SBP) figures show that while Rs 389 billion had been disbursed by June 2014, surpassing the target of Rs 380 billion, the banks' credit to agriculture has been around 5.7% of the banks' total advances.

The problem is especially serious in the case of small and marginal farmers. 'The under-pricing of credit in earlier years was a factor in limiting the outreach of credit to medium and large farmers who had acceptable collateral and had a clout to engage in corrupt practices with credit agencies. There is a need to ensure the access of small farmers and marginal farms to credit of different maturities' (SBP 2014).

Current situation

Agricultural credit in Pakistan is provided by a combination of two specialised public sector banks, five major commercial banks and 14 domestic private commercial banks. Annual targets for agricultural loans are set by the National Consultative Council, on the recommendations of the Agricultural Credit Advisory Committee (ACAC). Total yearly flow of agricultural credit in Pakistan increased at average annual rate of 23.6%, from Rs 32.6 billion in 2000-01 to 263.0 billion in 2010-11. After allowing for inflation, in real terms, this equated to average annual rate of growth of 11.3%. In real terms, the annual flow of agricultural credit peaked in 2007-08 and has been declining each year in subsequent years.

During the ten-year period ending in 2010-11, a major change has occurred in the sources of formal agricultural credit in Pakistan; the combined share of the two specialised banks in total agricultural credit fell from 73% in 2000-01 to 27%, whereas the combined share of commercial banks rose from 27% to 53% and that of the domestic private banks increased from zero to 19%. During the same ten years, formal agricultural credit per acre of agricultural land also peaked in 2007-08 and has declined every year since then. The same is true of agricultural credit as a share of agricultural GDP, which peaked at 10.5% in 2007-08 and then fell every year to 7.1% in 2010-11 (lower than it was in 2004-05).

Policy issues

- Should agricultural credit policies (and targets) be made an integral part of a broader national strategy for uplifting the smallholder farmers' livelihoods?
- How should the imbalances in the current credit disbursement policies (e.g., crops vs horticulture; rich vs poor farmers; agriculture vs livestock and dairy) be addressed?
- How should credit policies meaningfully and effectively take into account the changing nature of modern value chains and the need for building the capacity of men and women smallholders to successfully participate in these markets by meeting their food safety and consistency standards?
- How should smallholders be provided with innovative and effective market-based risk management options, including weather index insurance?
- How should bank lending procedures be made less cumbersome and daunting without compromising financial prudence?

In 1995, caps on maximum lending rates were removed, and in 1997, minimum lending rates were also deregulated. Currently, lending rates for agricultural credit vary between 9% and 24%. In our field studies in Punjab and Sindh, most respondents

reported lending rates of 17-19%, and only a few reported taking these loans. Most respondents reported that they relied on informal credit sources where rates of interest are lower – even though there are other restrictions that go with such credit (e.g., selling produce to lenders at concessional prices).

Unmet demand for agricultural credit

Dr Masood Bakhtiar Siddiqui (2011) reported that a major problem in Pakistan is the small pool of credit available for agriculture (and livestock and dairy). In spite of contributing 21% of Pakistan's GDP, agriculture sector received only 8% of total credit disbursement in each of the three years to 2009-10. Furthermore, the share of non-farm sector (including livestock, dairy, fisheries, and horticulture) in agricultural credit is also disproportionately small. For example, in spite of having 60% share in agricultural GDP in 2010-11, the share of non-farm sector in agricultural credit was only 31% of the national total. According to Siddiqui, smallholders are receiving a major proportion of agricultural credit disbursement. For example, more than 85% of total borrowers in 2009-10 were smallholders (with land

holdings less than 5 hectares), who together received 59% of total credit disbursement in that year.

Dr Aamer Irshad (2012) estimated that the availability of agricultural credit in Pakistan fell far short of the total demand; for example, availability of credit in 2010-11 fell short of total demand by Rs 416 billion (61% of total demand); and that 'collusion of large farmers with the bank generally results in credit appropriation to non-eligible groups, defeating the purpose of disbursement of under-priced credit meant for the small farmers'.

Dr Khalid Bashir (UAF 2014) finds that out of the total credit disbursed in 2010-11, 24% was advanced for purchases of seeds/seedling and only 9% for dairy farming in Punjab. The corresponding shares in Sindh were 26% and 6%, respectively. The share of major crops is the highest in the loans extended for seeds/seedlings.

Pakistani farmers have less access to institutional credit. Siddiqui (2013) reported that on average Pakistani farmers are getting 75% of institutional credit compared with their Indian counterparts, but are also paying higher interest rates.

Smallholders' reliance on informal credit

There is overwhelming evidence in India and Pakistan that smallholders are not able to access agricultural credit from formal channels and that there is a need to encourage the banks to expand agricultural credit, especially to small farmers (Khan 2012). While the gap in total available agricultural credit is high, access to it is denied to most of the smallholders. For the smallholders, as much as 70% of demand for credit is still met by the informal sector. The lenders in the informal sector may not like repayment (of the loan) in cash and may make forward purchases of the crop at a rate of their choice, much less than the prevailing market rate. The lenders also exert social and political pressure on the borrower at the time of elections or other such social events (Irshad 2011).

Lack of credit makes smallholders more risk averse in adopting new technologies, crops and processes. For example, the proportion of smallholders not using fertiliser is much higher (up to 3 times higher) than the large holders, because fertiliser prices are high and credit is not available.

As suggested by Irshad (2011) above, many other experts also argue that the rural credit market is not independent, but is closely interlinked with rural labour market and product markets. For example, Basu (1983) and Shami (2012) suggest that in rural India and Pakistan, reliance on informal access to credit (from the landlords, contractors or merchants) also ties the borrowers to sell their labour and agricultural produce (milk, vegetables or fruit) to the creditors at concessional prices.

Field studies (preliminary) findings

Access to affordable credit is an important constraint for 81% of smallholder respondents in the field study of Punjab dairy farmers, but only 53% said that they used credit. Of those using credit, 88% were getting credit from informal sources, i.e., friends and relatives, or contractors and input suppliers. Also: 76% were using credit for farm related inputs; 94% of respondents consider that prices of better breeds of animals are too high for them to afford; and 75% of respondents said that prices of feed and fodder are too high.

Among the citrus producing households surveyed, access to affordable credit was reported as 'important or very important' constraint by 60% of households, but only 37% said they were using credit, 77% of whom relied on informal sources of credit. Of those who did not use credit, 54% said this was because either interest rates were too high, or they had no collateral, or they found paperwork for loans too complicated; and 77% of those using credit were using it for buying farm relating inputs.

Among the Punjab mango farmers, 55% said that they do not use credit. One-half of these said this was because interest costs of borrowing were too high. One-fifth did not borrow because they had no need, while one-tenth did not borrow due to lack of collateral.

Three-fourth of those who do use credit use it for mango farming inputs, while 15% of the rest use credit for non-mango farming inputs. Only a small proportion reported using credit to pay for family medical needs or a wedding.

Selected references

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