3 Access to affordable credit

3.1 Introduction

Agriculture accounted for 18.9% of Pakistan's national GDP in 2017–18. The livestock contribution in value added was 58.9%, while the crop sector's share was 34.4% (Government of Pakistan 2018). There are 8.3 million farms in Pakistan (6.7 million are owner farms and the rest owner-cum tenant and tenant farms), involving 64% of the rural population directly or indirectly, and employing 44% of the labour force of the country. A farmer is classified as a small farmer in Pakistan if the size of his or her holding is 5 hectares or less of arable land. Owing to continuous fragmentation of land, the number of small farms has increased over time. While 68% of all farms were small farms in 1972, the figure had risen to 89.5% by 2010. Nearly 65% of all farms in 2010 had less than 2 hectares of land—up from 28% in 1972. At the same time, farming land has become increasingly concentrated in larger farms and 89.5% of small farms cover only 47.9% of the cultivated area.

The official statistics show that in Punjab, average real monthly income of the first quintile (i.e. the bottom 20% of households) increased from Rs4,991 in 2001–02 to Rs8,876 in 2015–16 (Table 3.1). In Sindh, the same comparison shows that real average income improved a little from Rs6,456 in 2001–02 to Rs6,945 in 2015–16. As almost all the small farmers belong to this quintile, these comparisons portray smallholders' mixed results in real income growth over this period, especially in Sindh.

Table 3.1 Real household income, quintile 1, 2001–02 to 2015–16.

	Real monthly household income (Rs)	
Year	Punjab	Sindh
2001–02	4,991	6,456
2010–11	5,459	5,296
2015–16	8,876	6,945

Source: Household Integrated Economic Survey, Pakistan Bureau of Statistics (2017).

Small farmers' output is typically low and does not leave sufficient funds to undertake farm operations according to agronomic recommendations. According to the Planning Commission of Pakistan, 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 (Planning Commission 2010). Yet, most credit surveys show that small farmers are unable to access credit from formal channels and remain heavily reliant on informal credit—relatives and friends, the middlemen or input suppliers (Irshad 2011).

The specific aim of the *Enabling agricultural policies for benefitting smallholders in the dairy, citrus and mango industries of Pakistan* (ADP/2010/091) project was to improve livelihoods of small farmers by developing options for enabling policies that can overcome policy-related constraints faced by smallholders in the dairy, mango and citrus sectors of Punjab and Sindh. The ultimate aim was to increase small farmer incomes and make Pakistan a more inclusive economy and society.

Section 3.2 provides a discussion of the current status of agricultural credit in Pakistan. Major issues and challenges in extending the outreach of formal credit to smallholders are discussed in Section 3.3. Policy recommendations for addressing these issues are outlined in Section 3.4. Section 3.5 concludes with a summary.

3.2 Credit for smallholders in Pakistan

3.2.1 Current status of agricultural credit

The *Loans for Agricultural, Commercial and Industrial Purposes Act, 1973* (Government of Pakistan 1973) provides the legal framework for all types of credit facilities for persons engaged in agriculture. The State Bank of Pakistan makes regulations to achieve the annual credit targets fixed in consultation with all stakeholders included in the Advisory Committee on Agriculture Credit (ACAC). Credit disbursement occurs through a network of specialised and commercial banks with nearly 11,000 branches across the country; over 4,000 of these branches deal in agricultural credit.

Previously, the public sector Zarai Taraqiati Bank Limited (ZTBL) was the main provider of agricultural credit. Now, its share has been reduced in relative terms from 56% in 2001–02 to 13% in 2017–18 (Table 3.2) due to the rising participation in the Pakistan agricultural credit market of commercial banks (CBs) in 1995, domestic private banks (DPBs) in 2001 and microcredit banks in 2011. The figures in Table 3.2 suggest that agricultural credit in Pakistan is progressing from the state-provided credit phase to the market-based credit phase.

In support of the government's prioritising of the agriculture sector, the ACAC sets annual indicative targets for agricultural credit disbursement for participating public sector and commercial banks. During 2017–18 this target was Rs1,001 billion, which was 42% higher than the previous year's disbursement

Table 3.2 Changing market structure of agricultural financing (% of market share).

	ZTBL	CBs	PPCBL	DPBs	MFBs	IBs	Total
2001–02	56	33	10	1	-	-	100
2014–15	19	51	2	21	6	1	100
2017–18	13	51.5	1.5	20	12	2	100

ZTBL = Zarai Taraqiati Bank Limited; CBs = commercial banks; PPCBL = Punjab Provincial Cooperative Bank Limited; DPBs = domestic private banks; MFBs = microfinance banks; IBs = Islamic banks.
Source: State Bank of Pakistan (2018).

of Rs704.5 billion. Out of the total target, Rs516 billion has been allocated to five major CBs, Rs125 billion to ZTBL, Rs200 billion to 14 DPBs, Rs15 billion to Punjab Provincial Cooperative Bank Limited (PPBCLs), Rs100 billion to 11 microfinance banks (MFBs), Rs20 billion to five Islamic banks (IBs) and Rs25 billion to 15 microfinance institutions (MFIs) and rural support programmes (RSPs) for financial year 2017–18 (Government of Pakistan 2018).

Credit disbursement in 2016–17 was almost equally divided between the farm sector (crops and fruits) and the non-farm sector (mainly livestock, fisheries and poultry). However, the shares of credit disbursement to smallholders were quite different between the two subsectors. Within the farm sector, credit disbursement to subsistence holdings (small farmers) accounted for 26% of total credit, while within the non-farm sector, credit disbursement to small farms was only 18% of the total credit.

While agricultural credit disbursement has been on the increase in recent years, demand for agricultural credit in Pakistan has been growing even more rapidly and has been estimated at around Rs2,000 billion, revealing a large shortfall in the availability of agricultural credit (Table 3.3).

3.2.2 Recent credit schemes for smallholders

In recent years, the following credit schemes have been launched by the lending financial institutions focusing on small farmers.

3.2.2.1 Financing scheme for small farmers (group-based lending)

To address the problem of lack of security available to smallholders, a group-based lending approach has been introduced in Pakistan. Under this scheme, loans are made to individual farmers through peer groups called small farmers groups (SFGs), where all the members guarantee the repayment of each other's loans and social pressure is used as the intangible collateral. The size of the SFG is usually around 5–15 members. The group is either organised by the bank itself or through an NGO. The bank provides a loan on the joint guarantee of the farmers of an amount not exceeding Rs200,000 for crop or non-crop activities and term loan facility for farm improvements. Only small farmers are members of SFGs (State Bank of Pakistan 2015).

3.2.2.2 Credit guarantee scheme for small and marginalised farmers

The State Bank of Pakistan also developed a credit guarantee scheme, funded by the federal government, encouraging financial institutions to lend to small farmers (owning

Table 3.3 Agriculture credit disbursement, 2009–10 to 2017–18.

Year	Target (Rs billion)	Disbursement (Rs billion)	Increase (%)	No. of borrowers (million)	Change (%)
2009–10	260	248	–	1.46	–
2010–11	270	263	6.0	1.45	–0.7
2011–12	285	293	11.4	1.96	35.2
2012–13	315	336	14.7	2.00	2.0
2013–14	380	391	16.4	2.15	7.5
2014–15	500	516	32.0	2.19	1.8
2015–16	600	598	15.9	2.38	8.7
2016–17	700	705	17.8	3.27	37.4
2017–18	1,001	970	37.6	3.46	5.81

Source: State Bank of Pakistan (2018).

5 acres of land in canal-irrigated and 10 acres in rain-fed areas) who do not have adequate collateral acceptable to banks, in order to meet their working capital requirements (State Bank of Pakistan 2015). Participating financial institutions have been assigned credit disbursement targets of Rs2 billion in 2017–18. The federal government provides a guarantee for the default risk for 50% of the loans disbursed to eligible farmers. The maximum size of the loan under this scheme is fixed at Rs100,000, for a maximum period of 1.5 years. Since its inception, more than 50,000 eligible farmers have been financed under this scheme.

3.2.2.3 Promoting financial innovation

The Financial Innovation Challenge Fund (FICF) was launched in 2014 to promote innovative rural and agricultural financial services. Currently, FICF is supporting 12 institutions in testing innovations such as agriculture value chain financing, warehouse receipt financing, green agricultural financing, Islamic microfinance, and the use of ICT solutions for agricultural finance and price information. The State Bank of Pakistan is also promoting value chain financing for six main value chains, including beef and dairy (the others are potato, tobacco, Basmati rice and aquaculture). Under a pilot project, Rs5 billion were disbursed to around 4,500 farmers. The target of agricultural value chain financing for the financial year 2018 is Rs10 billion (State Bank of Pakistan 2015).

3.2.2.4 Crop loan insurance scheme

A crop loan insurance scheme had been introduced in 2008 to mitigate the default risk of small farmers and to provide repayment assurance to banks, especially in the case of natural disasters. The federal government bears the cost of the annual insurance premium of farmers with a landholding of up to 25 acres and growing any of the major crops (wheat, maize, cotton, sugarcane and rice). Since its inception, more than 3.8 million borrowers have benefitted from this scheme.

As the ACIAR project ADP/2010/091 focused on only citrus, mango and dairy farmers, the crop loan insurance scheme may appear to be irrelevant to this project. However, citrus, mango and dairy small farmers usually have mixed farming operations, in which they also grow some of the crops covered under this scheme.

3.2.2.5 Livestock insurance scheme

Despite its importance for the country as well as for individual farmers, the livestock sector's share in agricultural credit in Pakistan is around 20%. Limited availability of risk mitigating or insurance products is one of the main reasons for the low provision of credit for livestock. To encourage lending institutions to provide credit to this sector, a livestock insurance scheme was launched in 2013. The scheme was developed by the State Bank of Pakistan in collaboration with the Securities and Exchange Commission of Pakistan, banks, insurance companies, and provincial livestock and dairy departments, to protect small farmers in case of loss of animals from natural causes or disease or natural disaster, such as flood, windstorm or accident. The banks obtain insurance of all livestock loans up to Rs5 million for the purchase of animals. The government bears the cost of the insurance premium for small farmers. Farmers owning up to 20 cows/buffaloes and 50 fattening cattle have been classified as small farmers for this scheme (Government of Pakistan 2015).

3.2.2.6 Microcredit for smallholders

Since 2011, microfinance has been growing steadily in Pakistan. During 2014–15, a total of Rs30 billion was disbursed by microfinance banks. By the end of 2017, total credit disbursed by microfinance institutions had increased to Rs203 billion, indicating strong demand for microfinance in Pakistan (Government of Pakistan 2018). Several organisations, such as the rural support program network (RSPN), have also developed their own networks for providing microfinance to small and marginalised farmers. The RSPN model is primarily based on community organisations and group lending. The Pakistan

Poverty Alleviation Fund (PPAF) is another organisation extending substantial amounts of credit for poverty alleviation activities. A study by the University of Leicester (Hina et al. 2012) reported, however, that outreach of microfinance in Pakistan was mainly in urban areas. In a recent study of microfinance in several developing countries, the Asian Development Bank Institute has documented the growing participation of commercial banks in providing microfinance to small rural enterprises (Subhanij 2016). Initially, the commercial banks did not consider it worthwhile to enter microfinance business because the opening of branches in rural areas was much too costly. But, having witnessed the rapid growth of microfinance, commercial banks have developed innovative business models for entry into this market. Instead of opening their own branches, commercial banks in India, Mongolia, Thailand and Turkey have teamed up with successful microfinance providers who act as their agents. This business model should be of interest to Pakistan.

3.2.2.7 Branchless banking

Historically, a major reason for low access to financial services in Pakistan was the cost and time spent by low-income people to reach distantly located bank branches for carrying out their financial transactions. Women in rural and remote areas face additional constraints such as lack of mobility largely for cultural reasons. Technology has however been changing the dynamics of retail banking in Pakistan. Thanks to branchless banking, people can now access basic financial services at agent shops which are close to their homes. Eight branchless banking providers have developed a network of 125,000 agents to provide services including payment of bills, fund transfers, loan repayments and others. These agents performed a total of almost 192 million transactions worth Rs802 billion during the year 2013. By the end of 2017, the total number of branchless banking agents had increased to 405,671 and the total amount of credit disbursed through this mechanism had increased to Rs17.3 million (Government of Pakistan 2018).

3.2.2.8 Prime Minister's agriculture package

The then Prime Minister of Pakistan announced, at the Farmer's Convention held on 15 September 2015, a relief package for small farmers including direct cash support and provision of soft agriculture loans. This Rs341 billion package included some new schemes, as well as schemes already in operation during and before the 2015–16 Federal Budget.

Important points related to agricultural credit are given below:

- Solar tube wells would be provided on 'mark-up free' loans to farmers who own up to 12.5 acres of land. The mark-up of seven years would be paid by the federal government with a cost of Rs14.5 billion.
- The government would provide a 50% guarantee scheme on loans given by commercial and microfinance banks to farmers. Under the scheme, 300,000 small farmers owning 5 acres of irrigated land or 10 acres of rain-fed land can obtain a loan of Rs100,000 without collateral. The scheme will cost the government Rs30 billion.
- The government will bear the cost of premium against loans sought for crops. The measure will entail an expenditure of Rs2.5 billion and benefit some 700,000 small farmers.
- The State Bank of Pakistan will seek to reduce the mark-up rate on agriculture loans by two percentage points, providing a benefit of Rs11 billion per annum to farmers (Government of Pakistan 2015).

3.2.2.9 National Financial Inclusion Strategy

The Government of Pakistan launched a comprehensive National Financial Inclusion Strategy in May 2015 (Government of Pakistan 2015). Implemented by the State Bank of Pakistan together with support from private sector stakeholders, the Financial Inclusion Strategy is a specific initiative for implementation of the Pakistan Vision 2025, which embraces the goal of achieving inclusive economic development in the country. A decade ago in 2008, the Government of Pakistan had launched a Financial Inclusion Program with DFID (UK) support, which consisted of several initiatives for development of financial capacity, financial innovation and financial market infrastructure. This was followed by the establishment of a specialised Microfinance Credit Information Bureau in 2009 and a nationwide financial literacy program launched in 2012.

3.2.2.10 Empowerment of Kissan through E-Credit Scheme

The Government of Punjab has recognised that high fluctuation in commodity prices, increase in input costs, exploitation by 'commission mafia' and the lack of hassle-free financing from financial institutions has had a disastrous impact on financial viability of small farmers. Accordingly, the Government of Punjab launched the E-Credit Scheme in 2016 under the Empowerment of Kissan through the Financial and Digital Inclusion Program. Under the E-Credit Scheme, all farmers, including farmers with land holding of 12.5 acres, are eligible for interest-free crop financing loans, and around 70% of the loan is to be disbursed to farmers with no previous credit history. The loan disbursements are made to the farmer in three instalments of 40%, 30% and 30%, respectively. The purpose of disbursement in instalments is to ensure that farmers are utilising borrowed funds for agricultural activities and not for their personal needs (Government of Punjab 2015).

3.3 Major issues limiting smallholder access to credit

3.3.1 Low financial inclusion and financial literacy

Financial inclusion and financial literacy in Pakistan remain low by regional and global standards. In order to address the challenges of low levels of financial inclusion, Pakistan launched the National Financial Inclusion Strategy in 2015 (Government of Pakistan 2015). The strategy aims to enhance formal financial access to 50% of the adult population by 2020. Furthermore, lack of access to financial services is far more widespread among the rural population and women in Pakistan. Figures in Table 3.4 show that people in Pakistan have much lower engagement with financial institutions than is the case in South Asia as a whole, and that females in Pakistan have far lower engagement with financial institutions than Pakistani males, and than females in the South Asian region.

Table 3.4 Global Findex 2017: financial access and usage.

Category	Pakistan (%)	South Asia, average (%)
Borrowed from any source	49.8	48.7
Borrowed from a financial institution, 2011	1.6	8.7
Borrowed from a financial institution, 2014	1.5	6.4
Account at a financial institution, 2014	13.0	47.0
Account at a financial institution, 2017	21.0	70.0
Account at a financial institution, 2014, male	21.0	55.0
Account at a financial institution, 2017, male	35.0	75.0
Account at a financial institution, 2014, female	5.0	38.0
Account at a financial institution, 2017, female	7.0	64.0

Source: World Bank (2017).

3.3.2 Low credit disbursement for livestock and dairy farmers

Livestock and dairy farming is now a major component of the non-farm sector of Pakistan. Livestock is central to the livelihood of the rural poor and plays an important role in poverty alleviation in Pakistan. Within the farm sector (crops and fruits), credit disbursement to small farms (i.e. subsistence holdings) accounted for 26% of total credit disbursement in 2016–17. Within the non-farm subsector (livestock, fisheries and poultry), the credit disbursement share of small farms was only 18% of total credit, implying that the lion's share of credit disbursed in this subsector went to larger farmers (Government of Pakistan 2018). Thus there is a need to increase credit disbursement to small farmer households working in livestock, fisheries and poultry.

3.3.3 High transaction costs of lending to smallholders

The high transaction cost of lending to small farmers has always been a challenge for financial institutions, not just in Pakistan but around the world. Although the average size of agriculture loans in Pakistan is around Rs400,000, the maximum loan of some of the guaranteed loan schemes for small farmers is fixed by the Government at Rs100,000. From the banks' standpoint, however, the administrative and procedural requirements are the same for all loans, irrespective of their size. Thus, as a proportion of the amount of a loan, the transaction cost falls as size of the loan increases (Amjad and Hasnu 2007). To add to the problem, the transaction cost of lending is also high in Pakistan due to inadequate and unclear records of agricultural property—especially in the case of smallholders.

The result is that when banks charge a high rate of interest to recoup the transaction cost from the borrowers, smallholders (who deserve to be charged less due to their lower incomes) are faced with high rates of interest. This is on top of already-high interest rates in Pakistan, due to the high rates of inflation. As Mehmood et al. (2013) found, high interest rates have become one of the major concerns for small farmers, and 71% of farmers complained that rates charged by the banks were too high.

3.3.4 Lack of collateral for credit security

All banks prefer lending to borrowers who have sufficient marketable collateral to be used as a guarantee against the risk of default. In Pakistan, agricultural passbooks (official records of agricultural land) are used as a major source of collateral (i.e. around 55% of agricultural credit disbursement). Thus, a farmer without such collateral is a non-bankable farmer, and most smallholders fall into this category, as they have no land or not enough land. Unacceptable or inadequate collateral is the most important impediment to bank borrowing for small farmers (Akram 2008). Although in recent years other forms of collateral have gained acceptance, such as personal surety or pledge/hypothecation, ownership of land is still the single most important determinant of access to formal agricultural credit in Pakistan (Amjad and Hasnu 2007).

Even for those farmers who have land that may be used as potential collateral for borrowing from banks, the produce index unit (PIU), which is used by all banks for determining the maximum size of loan they would offer a farmer, causes further problems. The PIU reflects the productive capacity of land and is an official estimate of gross value of produce on each unit of land by soil type. This means that a bank's estimate of the maximum borrowing capacity of a farmer is always below the value of his land, not based on market value but on the PIU per acre. Within this upper limit, banks are also advised by the State Bank of Pakistan to be mindful of the price at which a farmer's land could be speedily disposed of, in the event of a loan default.

First established in Pakistan in 1947 for determining objective compensation for Muslim refugees for land they had left behind in India after the partition, the value of each

PIU represents a safe proxy for market value of land. It is updated periodically by the State Bank of Pakistan before being conveyed to all banks for lending guidance. In recent years, the value of the PIU has been adjusted several times. For example, its value was increased from Rs400 to Rs1,200 in 2007, from Rs2,000 to Rs3,000 in 2015, and from Rs4,000 to Rs5,000 in 2017. Critics point out that because the PIU value is always much lower than the market value of agricultural land, determining borrowing capacity of farmers according to PIU puts farmers at a severe disadvantage.

Those who cannot get credit from formal sources are forced to rely on informal sources. Informal credit markets are known to be interlinked (Irshad 2011). Reliance on informal sources of credit (from landlords, contractors or merchants) also forces borrowers to sell their agricultural produce (milk, vegetables or fruit) to the creditors at concessional prices. The lenders also exert social and political pressure on the borrower at the time of elections or other such events. Against this background, government intervention, such as group lending schemes, credit guarantee schemes and crop loan insurance schemes noted above, can be highly beneficial for small and marginalised farmers.

3.3.5 Cumbersome lending procedures

A number of studies have found that most farmers consider the banks' procedures to be too lengthy and cumbersome (Bashir and Azeem 2008; Akram 2008; Mehmood et al. 2013). Since collateral is a prerequisite for all kinds of loans, farmers are required to submit documentation proving acceptable tangible collateral. In most cases, the agricultural passbook provides the information about the land being used as collateral. This instrument is issued by the post office, filled by the revenue department and verified by the bank concerned. This is a cumbersome procedure which costs farmers not only a considerable amount of time and effort, but also sometimes 'speed money' (a bribe). Several researchers have noted bribery in the system to overcome or circumvent the cumbersome procedures (e.g. Akram 2008; Mehmood et al. 2013).

3.3.6 Unsuitable lending products

Banks typically offer standardised lending products, like general purpose production loans, that often do not meet the specific needs of all farmers, especially small farmers. Unlike the banks, informal lenders typically provide a line of credit based on the estimated value of the marketable produce of the borrower. The price of this produce and the timing of utilisation of the credit line are largely determined by the informal lenders, allowing them to maximise their profit at the cost of the borrowers. The state financial institutions and commercial banks need to develop innovative financial products to compete against the informal lenders.

3.3.7 Lack of information and guidance

General education and literacy rates in Pakistan are low. The Findex ranking noted earlier also shows this problem. Small farmers are also poorly informed about lending products and do not know how to meet the documentary requirements of the banks or how to fill in these documents. A recent study estimated that 82% of farmers lack financial knowledge and need guidance, but are not provided with that guidance (Mehmood et al. 2013).

3.3.8 Lack of cooperation of bank staff

In the past the State Bank of Pakistan followed the mandatory agriculture lending policy, but this has now been abandoned and the share of private sector banks in total lending has grown over time. However, the State Bank of Pakistan does not dictate that individual banks have to provide credit to small farmers. This situation creates an opportunity for the banks to work with only influential and large farmers. This business environment is reflected also in the lack of cooperation of bank staff with small farmers. Bashir and Azeem (2008) found that about 45.6% of small farmers were not satisfied with the behaviour of bank officials. Thus, there is a need for the Pakistan Government and the State Bank of Pakistan to improve the attitude and behaviour of bank staff towards rural borrowers, especially smallholders (many of whom are illiterate and easily intimated by bank staff and procedures).

3.3.9 Lack of credit in time of need

Many times farmers are unable to get a loan on time due to incomplete paperwork or lengthy bank procedures. Since farm operations are time-bound, any delay in the availability of loans has an adverse impact on productivity. In such circumstances, small farmers turn to more informal and convenient avenues of credit available from money lenders or middlemen. Inordinate delay in the availability of bank loans is, therefore, an important factor that contributes towards poor agricultural productivity growth. About 55% of farmers in a study stated that there was a delay in credit disbursement which may be attributed to the clerical procedures of the bank (Mehmood et al. 2013).

3.3.10 Lack of suitable credit for women

Access to credit is a significant determinant of women empowerment. The field study conducted by project ADP/2010/091 revealed that nearly 70% of females in Sindh and 85% in Punjab do not take credit due to high interest rates, complicated paperwork or slow processing of loan applications. The remaining women acquire credit that is used for meeting different domestic needs, such as for buying sewing machines, marriage of children and purchase of livestock. For example, some women said that they had borrowed funds from the Sustainable Access to Financial Capital Opportunities (SAFCO) at the rate of 13% p.a. interest for these purposes.

3.4 Summary and conclusions

The specific aim of project ADP/2010/091 was to develop policy options for addressing policy-related constraints faced by smallholders in the dairy, mango and citrus sectors of Punjab and Sindh. The ultimate goal of the project is to improve livelihoods of smallholders by connecting them with markets and modern supply chains on more remunerative terms. Adequate availability of credit for all farmers is a precondition for the increased use of modern inputs such as fertilisers, improved varieties of seed, and modern technologies and practices. Yet most credit surveys show that small farmers are unable to access credit from formal channels and remain heavily reliant on informal credit, from relatives and friends, middlemen or input suppliers.

This chapter has identified the major constraints that are responsible for the current unsatisfactory position in access to credit. Several initiatives taken by the Pakistan Government and the State Bank of Pakistan have also been noted. In spite of these initiatives, however, small farmers in general, and women farmers in particular, are unable to access credit from banks or other formal financial institutions when they most need it. As a result, these farmers turn to the informal sources of credit—middlemen and money lenders—who exploit the farmers with high rates of interest.

Pakistan needs to develop more innovative solutions to this problem, because without access to formal credit at affordable rates, livelihoods of small farmers will remain stuck where they have been for many years. On the other hand, provision of affordable formal credit would unleash a new wave of innovation—experimentation in horticulture and dairy farming—improving the livelihoods of millions of small farmer households. In addition, Pakistan would be able to expand exports of mangoes, citrus, and milk and milk products into neighbouring countries to the north and west that are deficient in these products and have the purchasing power to import good quality foods.

The recommendations below are therefore vital for Pakistan's economy and its goal of creating a more equal and inclusive society.

RECOMMENDATION 3.1

Increase the PIU values to better reflect market prices of land and update PIU values annually to ensure PIUs are always up to date. Set separate annual targets for credit disbursement specifically to small farmers in farm and non-farm sectors of agriculture, and seek annual progress reports from all financial institutions engaged in agricultural lending and microfinance.

Motivation

The use of PIU values sets upper limits for agricultural loans from banks at artificially low levels. In the current system of credit disbursement, there is also an implicit incentive for financial institutions to cater for large borrowers. Credit disbursement targets are set in total amount of credit, irrespective of how many clients are served by it. Thus, the banks can meet their targets without extending their outreach. It is also cheaper and less risky for a bank to meet a given disbursement target by concentrating its lending on a small number of large borrowers, rather than providing credit to a large number of small farmers. This implicit incentive for banks should be neutralised to allow credit disbursement to smallholder farmers to grow.

RECOMMENDATION 3.2

Increase the credit disbursement share of the livestock subsector to reflect its high economic and social importance in Pakistan. Make up-to-date assessments of credit requirements of small farmers in livestock, dairy and fruit at various stages of their farming cycles and ask banks to design appropriate credit instruments to match the assessed credit demand.

Motivation

While the non-farm subsector (livestock, fisheries and poultry) was responsible for 51% of total agricultural credit disbursement, within the non-farm sector credit disbursement to small farms was only 18% of total credit, indicating that the lion's share of credit disbursed in this subsector went to large farmers. Furthermore, as credit needs of small farmers can be seasonal, financial institutions must be fully aware of credit demand cycles and should tailor credit products accordingly.

RECOMMENDATION 3.3

Provide encouragement and incentives for financial institutions that do not currently provide credit to small farmers to develop partnerships with microfinance institutions to extend their outreach into small farmer communities.

Motivation

In recent years, commercial banks in several developing countries, including India, Mongolia, Thailand and Turkey, have teamed up with successful microfinance providers to increase the banks' outreach into rapidly growing microfinance markets. Instead of opening new bank branches, which are much too costly for this type of business, commercial banks have *developed innovative models of relationship banking in partnership with existing microfinance institutions. Pakistan's commercial banks need to adopt similar innovations, creating win–win outcomes for both the banks and small farmers.*

RECOMMENDATION 3.4

To complement branchless banking and ICT-based credit facilities, the State Bank of Pakistan should direct all commercial banks to open scaled-down rural branches for serving rural populations, especially small farmers.

Motivation

High transaction costs of bank loans to small farmers have been a major constraint on the banks' ability to provide credit to smallholders. Branchless banking and ICT-based credit facilities have been introduced already in Pakistan with success. Overseas experience, especially in Indonesia, suggests that scaled-down rural bank branches can also reduce transaction costs and enable banks to provide formal credit to smallholders.

RECOMMENDATION 3.5

Set higher growth targets for agricultural value chain financing as a part of the Pakistan Vision 2025, by focusing particularly on small farmers, including women, in dairy, citrus and mangoes; and encourage greater involvement of smallholder producer organisations, contract farming, rural support programs, and NGOs in value chain financing.

Motivation

Although value chain financing has been introduced already in Pakistan, a more proactive and small-farmer-oriented approach, for example, using the banner of the Pakistan Vision 2025, would increase participation of small farmers in value chain financing. In many countries, private sector stakeholders and NGOs have become involved in facilitating the formation of small farmers' cooperatives or producer companies that are able to secure better access to credit and more favourable terms for marketing. This needs to happen in Pakistan too.

RECOMMENDATION 3.6

Strengthen and broaden the coverage of financial literacy campaigns by targeting smallholders, including women, initially as a pilot project in selected areas of Punjab and Sindh, and then mainstream after learning from the pilot projects. Involve smallholder organisations, such as rural support programs and credit cooperatives, in this initiative. Encourage collaboration with the private sector and NGOs to conduct workshops and demonstrations.

Motivation

Outcomes of financial inclusion and financial literacy as measured by the World Bank's Global Findex are low in Pakistan, although Pakistan has already launched a nationwide financial literacy program. Currently, small farmers have little knowledge of financial instruments and have little trust of financial institutions. Better levels of financial literacy would improve both their understanding of financial products and their trust in financial institutions.

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