Credit in Rural Pakistan: Barriers for Smallholder Farmers and Potential Policy Solutions

This policy brief has been prepared *as a part of ACIAR project ADP/2016-028-Creating Wealth in Smallholders Farms through Efficient Credit Systems in Pakistan*[1]

Key messages

- Credit services are important for improving productivity and wealth creation for smallholder farmers.
- Microfinance services and specialized banks are main providers of credit for smallholders.
- Availability and convenience of finance plays a larger role in borrower decisions compared to interest and service costs – borrowers are susceptible to poor financial choices.
- Latent demand exists for Islamic financing services.
- Awareness of government assistance schemes is low.

Credit in developing countries enables the expansion of smallholders' opportunities to increase their farm productivity and profitability (Duflo, et al., 2006, Fakudze and Machethe, 2015). Despite the increase in sources of formal and informal agricultural financing in recent years, smallholders still have limited access to credit in Pakistan.

Background

This project aims to investigate two proven levers of smallholders' wealth creation in Pakistan in the form of more efficient credit markets and schemes that promote entrepreneurial opportunities for women. Understanding the success factors and barriers to effectiveness in these two areas will enable the design of more effective schemes and policies.

What did we observe in the 2015 ACIAR study on Pakistan smallholder productivity?

This study follows from ADP 2015/2014 which involved a large survey of smallholder farmers in the Pakistan Punjab (n=800). That study measured many factors that could affect farm productivity, including access to markets, farming practices and innovation. One finding from the results was that access to credit on reasonable terms was linked to farm productivity and profitability but less than 50% of farmers in that sample had applied for credit and most were unsuccessful.

Latent demand exists for Islamic financing services.

In the survey, 75% of farmers who had received a loan stated they would prefer Islamic finance. Only 17% of farmers had received a loan from an Islamic finance provider which means that the demand for Islamic finance is currently not being met and could be discouraging some farmers from seeking finance due to religious reasons. The evidence for this can be seen in responses from non-borrowing farmers. Only 11% of non-borrowers would consider conventional microfinance compared to nearly half (48%) who would accept Islamic microfinance.

Among Islamic finance providers, Qarde Hasan (71%) and Murabha (13%) were the most common forms of credit for smallholders.

How do smallholder farmers access credit and what do they use it for?

In the current study we extensively surveyed nearly 800 Punjab smallholders about credit, financial services and farming practices. These were mixed farms that included horticulture, livestock and grain.

Of those surveyed, 47% had taken some form of loan in the past three years. While there are many formal and informal avenues for credit, microfinance banks (44%), MFI/NGO (23%) and specialised banks (14%) accounted for most of the lending activity to these farmers.

The majority of borrowing farmers used credit for operational purposes to smooth out cash flow through the year. For example, farmers used credit to buy seeds and fertilizer and then repaid this loan at harvest time. A small number of farmers (less than 10%) used loans for capital investments. This in concerning because capital investments such as equipment and land purchases are likely to have greater effect on productivity improvement over time. Increasing credit for productive capital investment represents an opportunity for agricultural development policy.

The survey data showed that most farmers considered availability and convenience as the main reason for their choice in financial services. Fees and lending costs received less attention which means that farmers could be making bad financial choices.

Awareness of government assistance and financial literacy is low.

Farmers with experience of banks and financial services were more likely to be borrowers of money. Without experience and understanding of banks and lending, borrowing is difficult.

The State of Punjab has introduced schemes to assist borrowing but awareness of this among small holders is low. Only 23% of borrowers and 11% of non-borrowers were aware of the Punjab Kissan Package and less than half of these borrowers were registered for the package. This suggests problems with communication and access to these programs. Akhuwat (60% of registered borrowers) and ZTBL (25%) are actively promoting the schemes and account for most of the farmers taking up the schemes.

Policy makers need to review the communication and access to these schemes if they are to be effective.

Main risks for credit default by farmers

- Climatic events such as drought and flood.
- Rising costs of inputs such as water, energy, fertilizer and pesticides.
- Outbreaks of pests and diseases.
- Financial emergencies such as medical costs and house repairs diverting loans away from farm production.

Policy recommendations

Microfinance is playing a significant role in the development of smallholder farms but farmers need better awareness to make decisions. General improvement in financial literacy will raise borrowing rates. Mobile phones and radio could be used to promote learning.

Islamic finance can play a greater role in the business of farming. There is an unmet demand and policies should be introduced to promote Islamic financial services.

Farmers are not very aware of government schemes and only some lenders appear to be promoting the financial assistance schemes. Promotion to raise awareness and cooperation with lenders is needed.

Further Information

Tisdell, C., Ahmad, S., Nadia, A., Steen, J. and Verreynne, M-L. (2017). Loans, Wealth Creation and the Socioeconomic Situation of Women in the Taluka Area of the Khairpur District, Sindh, Pakistan: A Study Based on Interviews with Female Focal Groups, Working Paper No. 62 Social Economics, Policy and Development, School of Economics, The University of Queensland, Australia. https://rsmg.group.uq.edu.au/files/2788/WP62.pdf