

Issue in the Development of Rural Finance in Pakistan

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Plan of the Presentation

- Importance of Rural Finance for development and poverty reduction in Pakistan – Issues and Constraints
- Focus of existing system on Agricultural credit only
- Recent Initiatives of the SBP
- Required Elements for an Effective Policy on Rural Finance

Rural Finance is about providing financial services for **all people** living in **rural areas**

Building the capacity to deliver ***improved financial services*** which meet the needs of ***all rural households and businesses*** is the most important policy ***challenge*** at this time.

Historically the State Bank focus has been
on agricultural credit alone

The State Bank Act - Chapter III section 8
paragraph (3) states that
The bank shall create a special Agricultural
Credit Department

But agriculture is now a small
albeit important part of the
rural sector

The Rural Sector is crucial for Pakistan's economic development and poverty reduction

- 68% of the Pakistan's population lives in rural areas
- The share of agriculture in GDP has dropped to 21.6 percent in 2006 from 53 percent in 1950.
- The incidence of rural poverty is overwhelmingly high.
- In 2001-02, the incidence of rural poverty was 17% higher as compared to urban areas.
- 60% of Pakistan's rural poor are landless.
 - 45% are non-agricultural households
 - 15% are landless agricultural laborers.

Farm and Non-Farm Poverty Headcount by Agro-Climatic Zone

Agro-Climatic Zone	FY1994		FY1999		FY2002	
	Farm	Non-Farm	Farm	Non-Farm	Farm	Non-Farm
Rice/Wheat Punjab	21.6	39.9	22.3	33.1	24.9	40.4
Mixed Punjab	16.9	25.8	30.5	34.6	40.9	48.3
Cotton/Wheat Punjab	19.9	31.4	35.2	44.7	42.1	55.6
Low Intensity Punjab	15.3	28.3	40.2	63.4	48.9	54.6
<i>Barani</i> Punjab	15.7	12.5	3.9	10.1	24.2	25.2
Cotton/Wheat Sindh	33.4	34.2	20.4	32.2	59.3	57.7
Rice/Other Sindh	25.7	27.1	19.5	14.6	60.8	53.0
NWFP	23.0	32.3	31.7	31.1	45.7	47.6
Balochistan	33.0	21.1	31.3	26.7	40.4	39.4

Source: Malik (2005)

Sources of non-farm income: % distribution of reporting households

Source of non-farm income	Farm households	Non-agri households	Livestock holders
Service	11.9	22.7	8.0
Business	7.1	19.5	8.4
Livestock	3.0	0.3	9.4
Remittances	2.9	1.7	1.3
Agriculture labour	21.6	4.9	14.9
Non-agri. Labour	18.5	42.5	46.8
Rent	1.6	0.7	0.9
Poultry	0.2	0.2	0.4
Others	6.6	7.5	9.9
None	26.5	0.0	0.0

Source: Agriculture Census (2000)

Labour Force Survey 2001-02 indicates that most of the non-farm establishments in Rural Pakistan are Informal

Industrial establishments	Formal (%)	Informal (%)	Total (#)
Mining	89.7	10.3	29
Food manufacturing	25.4	74.6	185
Textile manufacturing	29.8	70.2	738
Wood & paper manufacturing	11.2	88.8	143
Chemical, metal/nonmetal	56.2	43.8	338
Other manufacturing	33.8	66.2	68
Electricity & gas	98.3	1.7	120
Construction	15.7	84.3	1,220
Wholesale & retail trade	2.1	97.9	1,814
Transport & comm.	21.7	78.3	980
Finance & insurance	46.4	53.6	56
Social services	83.1	16.9	1,486
Household/personal services	5.6	94.4	716
Total (%)	30.2	69.8	
Total (#)	2,383	5,510	7,893

Employment Status of Rural Workers:

Labour Force Survey (2001-02)

- Employment status of rural workers (farm and non-farm):
 - self-employed (42%),
 - wage employees (31%), and
 - unpaid family workers (26%).
- Employment status of non-farm workers:
 - paid employees (59%),
 - self employed (32%), and
 - unpaid family workers (8%).

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Sources of Rural Incomes – Malik 2005

- Crop Income accounts for only 50 % of rural incomes.
- Wages and salaries and Transfer incomes are also significant sources.
- The incidence of poverty is low in zones where the percentage of incomes from wages and salaries and transfer incomes is high.
- Spearman rank correlation coefficient between the headcount of poverty and the percentage share from crop income for the year 2001-02 = +0.87 confirming that higher levels of poverty are associated with greater reliance on crop income.

Sources of Rural Incomes (continued)

- Better off households in rural areas derive a larger share of their income from crop production.
- Due to the unequal distribution of land - increase in crop income serves to exacerbate inequality.

Farm and Non-farm sectors

- Because of shrinking employment opportunities in the agricultural sector, the rural non-farm sector becomes very important for both, the landless as well as the small farmers.
- Available literature shows that the poor depended mainly on unskilled labor and self-employment for income.
 - Construction and services sectors are the two largest employers of rural non-farm labour force.
 - Construction sector absorbs unskilled and/or low-skilled labour.
 - Services sector appeared as the most important source of non-farm income for the better off households.
 - In addition, wholesale and retail trade and transport and communication also contribute significantly in the non-farm income of households belonging to higher income groups.

Distributional Implications of Agricultural Growth – Dorosh, Niazi and Nazli (2005)

- SAM based model simulations indicate that even large increases in agricultural production have only minor impacts on incomes of agricultural laborers and the rural non-farm poor – 10% increase in agricultural income leads to only 2 percent increase in incomes of the poor.
- The implication is that agricultural growth alone, (even including multiplier effects), **without specific interventions targeted to agricultural laborers and the rural non-farm poor, will not alleviate poverty for much of the poor in rural Pakistan.**

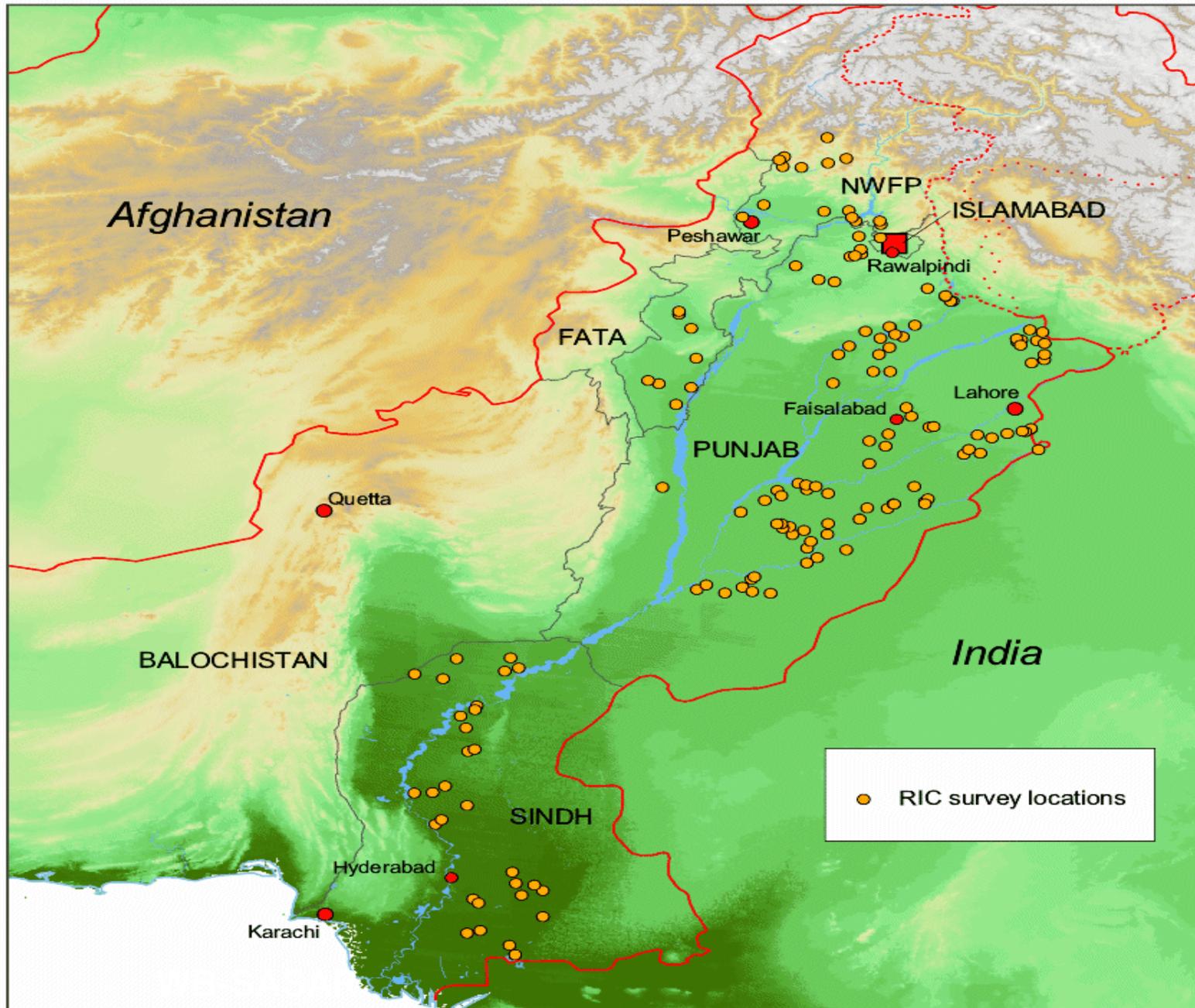
Data Gaps

- Because of the lack of disaggregated data, it is not possible to adequately examine the location, structure and functioning of the existing non-farm sector.
- Lack of such data limits the in-depth analysis of non-farm sector in rural Pakistan.
- Following data gaps can be identified in the available sources:
 - Nature of existing non-farm activities—type of work
 - Number of hours worked in these activities.
 - Nature of employment—casual or permanent
 - Employment status
 - Annual or monthly earnings/profits if self employed
 - Hourly wage rate if employed
 - Full information on credit facilities
 - Marketing information

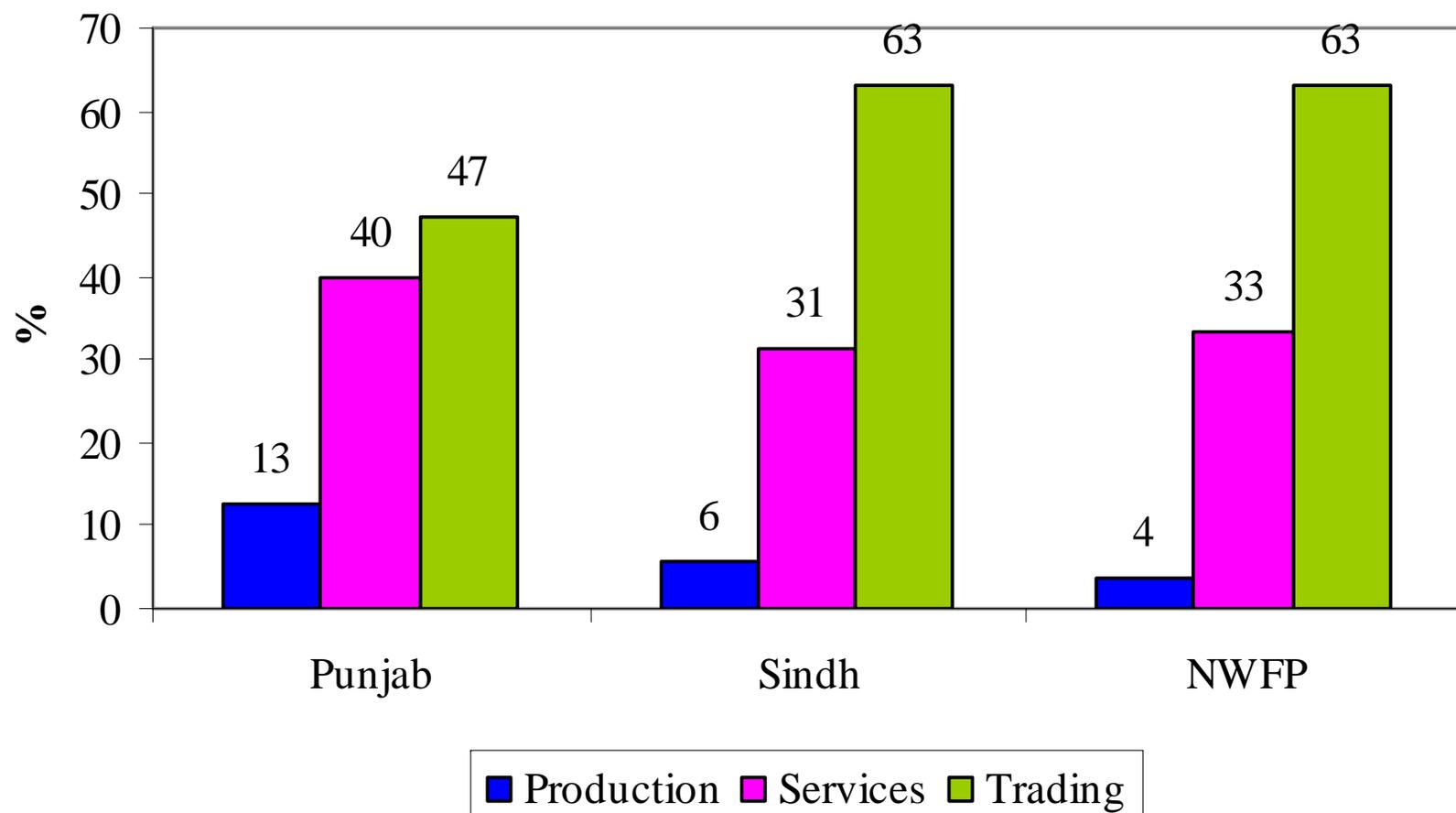
Rural Investment Climate Survey
(RICS) 2005 fills some of these
gaps

The Pakistan Rural IC Survey

- Survey covers 3 provinces
 - Punjab, NWFP, Sindh
 - 4 modules in the survey: enterprise, household, community and price surveys.
- 50% of the sample is drawn from rural villages (Union Councils)
- 50% is drawn from small towns; Town Committees (TC) and Municipal Committees with population < 100,000
- In each selected village/TC, 10 enterprises are randomly selected (7 with ≥ 2 workers, 3 with ≤ 2 workers).
- The sample also includes 6 households w/ out enterprises.



Distribution of Enterprises by Type and Province



Basic Profile of Enterprises

		Punjab	Sindh	NWFP
Average age of enterprise (years)				
	Rural	9.2	9.9	12.9
	Urban	9.0	9.6	14.5
Stand alone enterprises (%)				
	Rural	67	99	96
	Urban	94	97	99
Share of firms registered (%)				
	Rural	22	5	4
	Urban	31	13	14
Sole proprietorship (%)				
	Rural	94	97	96
	Urban	95	92	94

Size of Employment

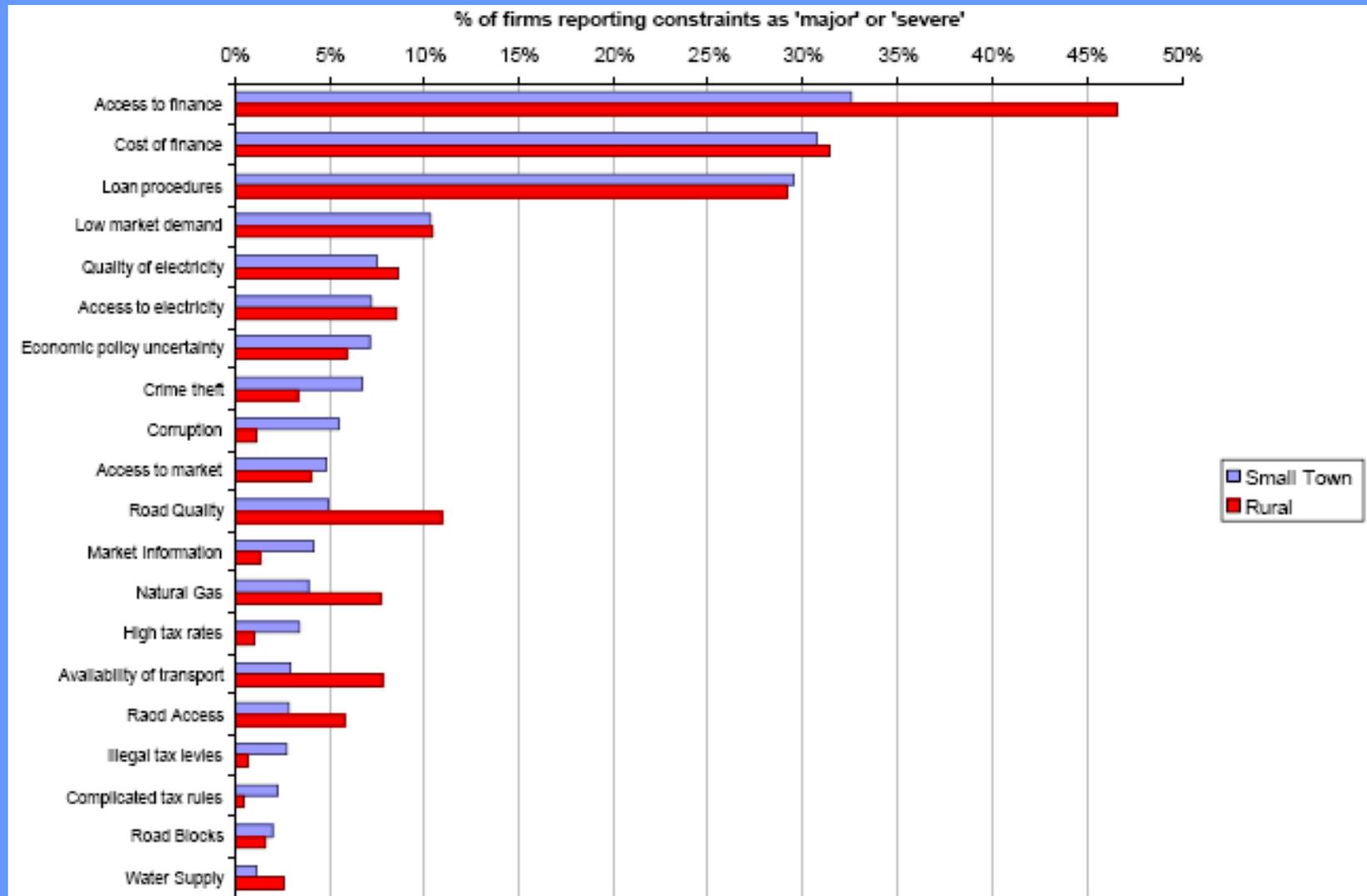
		Average No. of workers	No. of Family workers	No. of Hired workers
Punjab	Rural	1.9	1.4	0.6
	Urban	3.7	2.0	1.8
Sindh	Rural	2.8	2.4	0.4
	Urban	3.5	2.6	0.5
NWFP	Rural	2.1	1.8	0.3
	Urban	2.7	2.0	0.7

Market Linkages—Sales (Production Establishments) (%)

		Punjab	Sindh	NWFP
Share of sales at following places:				
	Own village	30.1	58.3	64.3
	Same UC different village	26.2	20.8	21.4
	Same tehsil different UC	22.7		7.1
	Same district different tehsil	11.7	4.2	7.1
	Same province different district	5.9	16.7	
	Other province	3.5		
Share of sales to following:				
	Government	2.2		
	Traders	11.4	5.0	9.1
	Parent company	0.5		
	Large domestic firm	4.9		
	Agricultural producers	4.9	10.0	
	Households	48.9	60.0	81.8
	Other	27.2	25.0	9.1

Rapid rural modernization
requires access to finance for
growth

But the Key Constraint for the Non-Farm Sector is Access to Finance - RICS

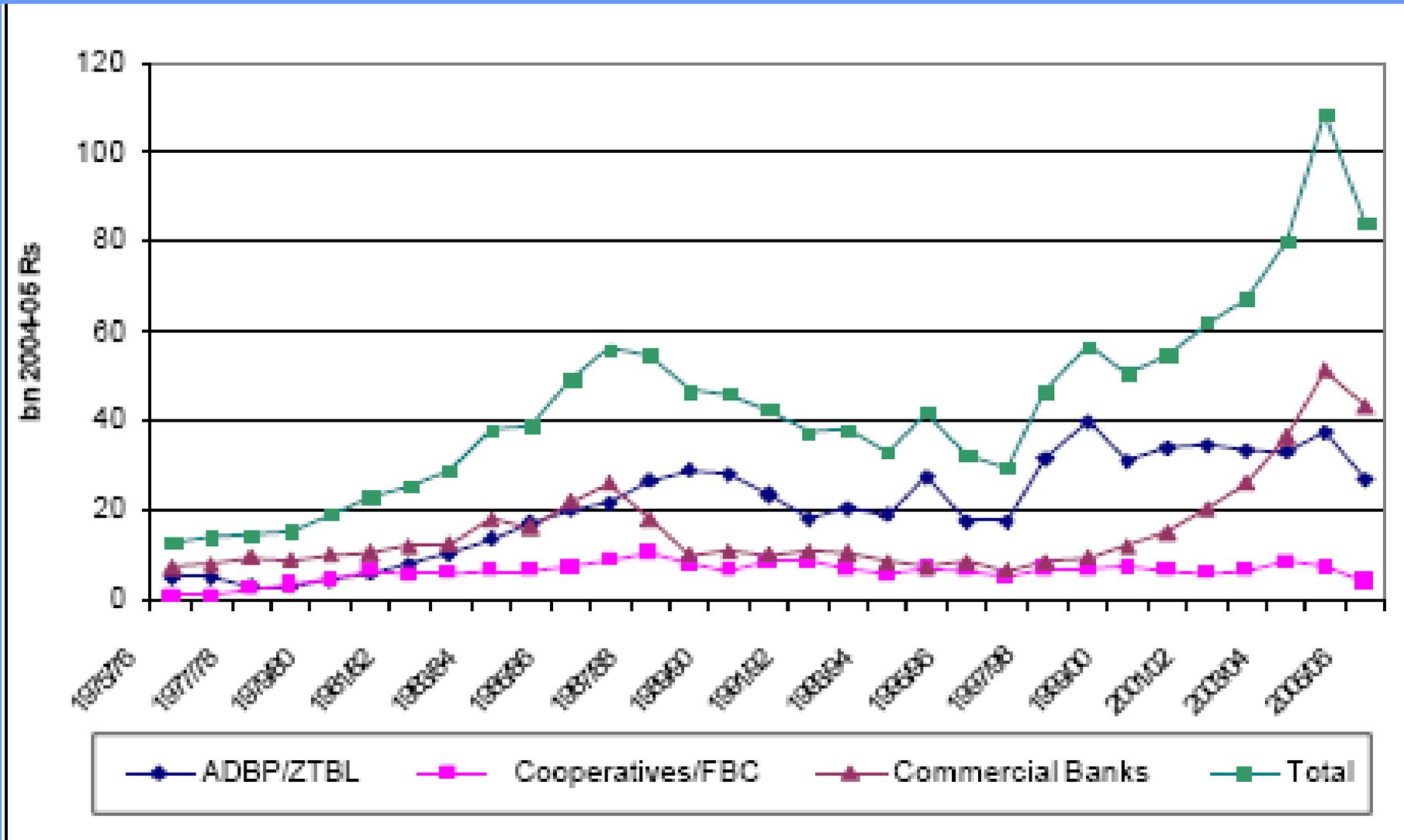


Investment Constraints by Order of Importance by Province (%)

	Punjab	Sindh	NWFP
Financing	64.6	39.9	75.8
Public utilities	46.3	31.7	20.6
Transportation	28.0	28.5	26.8
Governance	25.2	6.7	2.2
Marketing	30.1	7.7	7.4
Taxation	5.1	5.8	1.1
Labour	3.4	0.7	2.2
Agriculture policy	1.5	1.4	1.4
Registration/license/permits	1.1	2.7	0.4
Land	0.7	0.4	8.2
Environmental policy	0.8	0.0	0.7
Non-agricultural trade policy	0.5	0.3	0.0

Enormous Progress has been made in terms of the Growth of Institutional Agricultural Credit in recent years!

Growth of Institutional Agricultural Credit



Commercial Banks have taken on a lead role in Agricultural Credit

Banks	FY06	
	Amount	Share
Five Big Commercial Banks	68.0	49%
Domestic Private Commercial Banks	16.0	12%
Total Commercial Banks	84.0	61%
Specialized Banks (ZTBL+PPCBL)	53.5	39%
Total Disbursement	137.5	100%

Agricultural Credit is Flowing Predominantly to Small Farmers

Sector		FY06	
		Disbursement	Share %
A	Farm Credit	115.5	84
1	Small Farms	104.8	76
<i>i</i>	<i>Production</i>	95.8	70
<i>ii</i>	<i>Development</i>	9.0	7
2	Large Farms	10.7	8
<i>iii</i>	<i>Production</i>	9.4	7
<i>iv</i>	<i>Development</i>	1.3	1
B	Non-farm Credit	22.0	16
3	Small Farms	9.7	7
4	Large Farms	12.3	9
	Total (A+B)	137.5	100

	Small Farms(1+3)	114.4	83
	Large Farms (2+4)	23.0	17

Recovery Rates of ZTBL and PPCBL Need to be Improved

Banks	2005 - 06
Five Big Commercial Banks	92%
Domestic Private Commercial Banks	106%(*)
PPCBL	63%
ZTBL	55%
Overall	73%

Mark-up Rates on Agricultural Credit 2006

Bank	Production Loan	Development Loan
ZTBL	* 9%	* 9%
PPCBL	12%	15%
5 big Commercial Banks	12-14%	12-15%
The Bank of Punjab	KIBOR + 3.5%	KIBOR + 4.5%

* Reduced to 8 % if paid on time

But non-farm credit has accounted for
ONLY 14 to 16 percent of
total agricultural credit
between 2004 to 2006
and
the bulk of this non-farm credit is for
livestock.

SBP Initiatives to boost Agricultural Credit

- Introduction of a revolving credit scheme in 2003 under which 3 years running finance for production loans are given by banks to the farmers. The scheme is successfully progressing and constitutes 65% of the agricultural portfolio of banks.
- Credit documents have been simplified and standardized for convenience of borrowers.
- Local advisory committees have been set up at 16 offices of SBP to resolve the issues at local level.
- Separate prudential regulations for agricultural credit have been issued to make the procedure of lending easy and transparent.
- Guidelines for Livestock Financing have been issued

SBP Roadmap for Agricultural Credit

- To increase number of borrowers from 1.6 million at present to 3.3 million and enhance flow of credit to meet 75% country's credit requirement as against 45% at present in the next 3-4 years.
- Awareness and capacity building of financial institutions through on going specialized training program coordinated by SBP.
- Facilitate introduction of crop and livestock loans insurance. (A task force has been set up to give recommendations in 3 months).
- Strengthening the regulatory environment and to encourage banks to formulate more borrower friendly products to enhance agricultural credit out reach.
- Continue strengthening of Agricultural Credit Advisory Committee (ACAC).
- Guidelines for financing inland and marine fisheries are under process.

The Challenge:

- Defining a strategy that moves the Banking sector into what is perceived to be the relatively uncertain and potentially higher cost rural sector and away from the extremely profitable urban sector (huge spreads!) without distorting prices through subsidies

The rural finance strategy should

- identify the mix of regulatory and other measures necessary to move the banking sector into the rural areas
- draw upon international best practices to provide guidance to the banking sector in defining innovative products and services.

Rural Finance is all encompassing

- The strategies being defined for Micro-Finance, SMEs, Housing and Islamic Banking etc. under the current Development Policy initiative of the State Bank should **all have a predominant rural focus**

Issues in Rural Finance

- Provision of credit for **farming activities** is seen as the primary objective of **institutional credit** policy. The host of non-farm activities such as trade, processing, storage, transportation and provision of other support services are neglected.

Issues in Rural Finance

- The ability of the financial sector to mobilize rural resources and provide financial intermediation is generally ignored. The existing survey based estimates of non-institutional credit are indicative of this potential.

Issues in Rural Finance

- The rural sector in Pakistan is largely unbanked in Pakistan. Issues of relative profitability, information constraints, transaction costs, inadequate collateral etc are well known.

Issues in Rural Finance

- In addition to the thin rural financial market **financial exclusion** - the inability to access necessary financial services in an appropriate form – is also an issue.
- This financial exclusion can result from difficulties relating to **conditions, prices, or marketing of financial services**, but also arises from **lack of awareness about financial services and from self-exclusion**, often in response to religious and cultural perceptions

Required Elements of an Effective State Bank Policy on Rural Finance

- Data – Outdated and inadequate. Access to Finance Survey does not adequately sample rural enterprises – Inadequate information on what works and why especially globally
- Policy Research – Serious Capacity issues – need for innovative policy interventions and products and services

Policy Research – Some areas

- Product Diversification
- Risk Management – insurance schemes etc.
- Geographic Coverage – Mobile banking, service centers etc.
- Islamic Products
- Collateral Issues – Group Lending etc.

Required Elements of an Effective State Bank Policy on Rural Finance

- Policy Formulation – Need for regulation, coordination and alignment with GOP MINFAL and Finance (PRSP) - Need for integration of different elements of SBP development policy initiative under rural finance
- Policy Information Dissemination – Need for far greater outreach, awareness building and feedback
- Policy Implementation – Capacity issues - especially in Banking sector
- Monitoring and Evaluation – Need for setting up effective system - Need for a representative nationwide panel survey of households and enterprises

Capacity is a Key constraint to
the success of this whole process

Thank You so much