Contents

1. Introduction

This review focuses on government, private sector and development assistance interventions to promote equitable access to responsible finance for small cotton farmers in the 'cotton belt' of Pakistan, namely the provinces of Punjab and Sindh.

It should be recognised that, historically, the focus of public sector financial agencies has been on agricultural credit alone, in terms of short-term production and medium-term investment credit, and this focus has been shared in other forms of lending to rural borrowers. Only recently have experiences with rural savings and small-scale rural insurance begun to gain impetus.

WWF-Pakistan has undertaken significant research on the opportunities for small-scale cotton growers in Pakistan to enhance their farm productivity by obtaining credit from official sources and schemes provided by banks and industries[1]. The WWF-Pakistan report's conclusion should be borne in mind as an important context for the many financing structures described in this review:

"Agricultural financing is not always constructively employed in Pakistan. Farmers lack the awareness and technical expertise to lucratively benefit from agricultural financing resources […] Moreover, not all farmers employ loans for the agricultural purposes they claim they would use them for […] Since they are supposed to repay their loan amounts in a stipulated time period and if their debt is not contributing towards their agricultural output, such farmers may face difficulties in meeting their expected cash flows. Sadly, such farmers enter the vicious cycle of indebtedness or are faced with legal action from their lender corporation. Often, farmers cannot comprehend complicated credit terms and documentation procedures with ease. They often delay their means to acquire loans through not submitting all necessary documents with the loan application form successfully in one attempt. They are also reluctant to enter into a debt deal as it necessitates a grave commitment to pay off in the stipulated time […] Efforts are needed on part of the farmer – to foster trust in the system and realise the benefits he can reward himself through cautious management of the loaned amount – and on part of the credit facilities – to reduce their complicated procedures and list of formal documentation, promoting one-window operations and simpler financing. Thereby, agricultural finance schemes would thrive, proving purposefully rewarding for both the borrower and the lender, eventually boosting agricultural productivity in Pakistan."

[1] 'Financial Requirements for Small Scale Farmers to Implement Better Management Practices' (WWF-Pakistan, 2007)

II. Main institutions involved in agricultural finance in Pakistan

The rural finance landscape in Pakistan

Historically, the only institutional channels for credit to agriculture in Pakistan were the Agriculture Development Bank of Pakistan (ADBP – now restructured as ZTBL) and the Provincial Cooperative Banks. They benefited from a subsidised agricultural credit line from the State Bank of Pakistan (SBP). As elsewhere, this subsidised financing proved neither immune to misuse nor sustainable. As a result, the Provincial Cooperative Banks in Sindh, NWFP and Balochistan ceased their operations.

Since 2001, institutional credit to farmers is supported by SBP credit lines to a variety of on-lenders: the ZTBL (former national agricultural development bank), commercial banks, Punjab Provincial Cooperative Bank (PPCBL) and domestic private banks. The breakdown of institutional agricultural credit currently provided to farmers (all crops) is indicated below.

Institutional agricultural credit in Pakistan 2006-2008 (Rs. / million)

Year	*ZTBL*	*Commercial Banks*	*PPCBL*	*Domestic Private Banks*	*Total*
2006-07	56,473	80,393	7,988	23,976	168,830
2007-08	66,938	94,749	5,931	43,940	211,560

Source: Agricultural Statistics of Pakistan, SBP, ZTBL

In many instances, agricultural 'traders' finance farmers who produce raw materials for them, often by providing inputs on credit. This is typical in cotton cultivation. In other situations, some private and non-government organisations are developing agricultural micro-finance, a development supported in recent years by the state.

The financing of Pakistani agriculture is also intimately linked to the activities of informal providers (family, neighbours and money-lenders). These sources play a vital role, especially for meeting the consumption requirements of thousands of small farmers along with meeting the need for irrigation water, labour, and fuel. Interest rates tend to vary from product to product and also by the type of borrower as well as lender.

Formal finance providers

State Bank of Pakistan (SBP)

The State Bank of Pakistan (SBP) is the central bank of Pakistan. SBP, in collaboration with a variety of intermediaries, provides credit facilities to farmers in Pakistan. SBP also sets out minimum standards for agricultural credit in its 'Prudential Regulations for Agriculture Financing'[2]. These regulations set out a code of conduct for institutions lending to the agriculture sector.

Within the SBP, agricultural finance activities are led by the Agricultural Credit Department (ACD). The core tasks of ACD are:

- To ensure adequate flow of institutional credit in rural areas
- To assess agricultural credit needs and develop infrastructure to meet these needs
- To initiate financial awareness-building programs for farming communities
- To support capacity building of commercial banks in agricultural finance activities

As such, the SBP-ACD should be considered a *principal partner for BCI* with regard to access to finance for cotton farmers – in terms of needs assessment, awareness raising and capacity building.

Another relevant department of SBP – in terms of potential BCI activities – is the Development Finance Support Department (DFSD), which works at grassroots level with farming communities. The core functions of DFSD are:

- Linkages with key stakeholders including provincial / district agriculture departments
- Organising farmer meetings (*agri-melas*) in collaboration with banks to increase awareness of financial services within the farming community
- Organising Regional Agri-Finance Focus Groups (see table below)
- Monitoring banks' progress towards achievement of agri-credit targets as well as capacity improvements to undertake agricultural finance

Scope of DFSD Regional Agri-Finance Focus Groups
• To discuss and evolve operational strategies for increasing outreach of financial services amongst the farming community
• To organize awareness & information dissemination programs for increasing awareness of the farming community about the financial services they can access from banks
• To discuss the regional growth trends biannually and give recommendations for increasing outreach levels for consideration of DFSD/DFG of SBP
• To collect feedback on various policies of SBP / banks / Government for development of rural finance in their respective areas
Source: SBP Development Finance Support Department

[2] Available at www.sbp.org.pk/publications/prudential/prs-agriculture.pdf

Credit Limit for Major Agricultural Crops

Each year, SBP issues 'indicative credit limits' per acre for production credit relating to various crops, including cotton. These limits are only indicative and banks are free to lend more or less of these indicative limits depending upon needs assessment at the time of lending.

Indicative Annual Credit Limits for Major Agricultural Crops, from September 2008	
Name of Crop	***Indicative per Acre Credit Limit***
Wheat	Rs. 16000/-
Paddy (Rice)	Rs. 19000/-
Cotton	**Rs. 21000/-**
Sugarcane	Rs. 30000/-
Source: SBP Enhances Per Acre Indicative Credit Limits for Crops, September 29, 2008 www.sbp.org.pk/press/2008/SBPEnhancedPerAcreIndicativeCreditLimitCrop.pdf	

The indicative targets are issued to 21 on-lending banks, including: ZTBL, five major commercial banks (ABL, HBL, MCB, NBP and UBL) and 14 domestic private commercial banks: Askari Commercial Bank, Bank Al-Habib, Bank Al-Falah , My Bank, Faysal Bank, Habib Metropolitan Bank, PICIC Commercial Bank, KASB Bank, Prime Commercial Bank , Saudi Pak Commercial Bank, Soneri Bank, Bank of Khyber, Bank of Punjab and Standard Chartered Bank (Pakistan).

SBP has set an indicative credit disbursement target of Rs. 250 billion for the agriculture sector for the current 2008-09 fiscal year (FY09) which is 18% higher than the actual disbursement of Rs. 212 billion in FY08.

Legal definitions of land holdings in Pakistan

The Land Reforms Act 1977 specifies surface area limits for so-called 'subsistence', 'economic' and 'above-economic' holdings for each of the four provinces, summarised below.

	Punjab	**NWFP**	**Sindh**	**Balochistan**	**Finance (% of total portfolio)**
Subsistence holding	Up to 12.5 acres[3]	Up to 12.5 acres	Up to 16 acres	Up to 32 acres	70
Economic holding	12.5 to 50 acres	12.5 to 50 acres	16 to 64 acres	32 to 64 acres	20
Above economic holding	Above 50 acres	Above 50 acres	Above 64 acres	Above 64 acres	10
Source: State Bank Of Pakistan					

Under the Agricultural Loans Scheme for commercial banks through the passbook system, SBP recommends the proportion of commercial financing which is to be directed toward each scale of land holding. This recommendation – which stipulates that commercial banks must lend 70% of their total agricultural portfolio to 'subsistence' farmers – is intended to ensure that smallholders are able to access credit. (Pending the deliberation of the Pakistan RWG, 'subsistence' farmers may be considered to equate to smallholders in the BCI definition.) For breakdown of cotton-cultivating

[3] One hectare = 2.47 acres

farms in Pakistan by size, see below.

Distribution of cotton-growing farms and cotton area by farm size in Pakistan, 2000				
Farm size	***Cotton-growing farms as % of total farms***	***Share of total cotton farms (%)***	***Average area under cotton (acres)***	***Share of total cotton area (%)***
Total private farms (6.62 million total)	25	100	4.9	100
Farms up to 5 acres	21	48	1.8	18
Farms of 5–7.5 acres	28	17	3.9	13
Farms of 7.5–12.5 acres	29	16	5.7	19
Farms of 12.5–25 acres	33	12	8.7	21
Farms of 25–50 acres	29	5	15.6	15
Farms of 50 acres and above	25	2	40.2	14
Source: Government of Pakistan (2000) cited in IFPRI (2008) www.ifpri.org/pubs/dp/IFPRIDP00800.pdf				

Zarai Taraqiati Bank Limited (ZTBL)

The Zarai Taraqiati Bank Ltd. (ZTBL), known until 2002 as the Agricultural Development Bank of Pakistan, is a public sector bank and the largest financial institution lending exclusively to the agriculture sector in Pakistan. ZTBL provides both financial services and technical guidance, and as such is broadly equivalent to NABARD in India.

ZTBL claims to serve around 500,000 farmers annually (50% of all institutional credit to the sector, but still a small minority of all farmers – see table above). The bank provides loans for a wide range of agricultural investments including inputs, tractors and other equipment, and irrigation schemes. While credit lines are extended by SBP, the Ministry of Food, Agriculture and Livestock (MinFAL) plays an active role in monitoring and supporting agricultural credit disbursement, including the 'Crop Maximisation Project' described below.

Case study: ZTBL projects relevant to BCI implementation
ZTBL-MinFAL Crop Maximisation Project
MinFAL operates its 'Crop Maximisation Project' in 109 villages in various districts throughout the country to increase the productivity/yield of crops. Under the project, MinFAL provides Rs. 299bn to ZTBL for loans to participating farmers for the purchase of inputs. Under the initiative, which is scheduled to continue to 2014, the credit needs of the project farmers are assessed and met by local ZTBL branches through Village Organisations formed for this purpose. The project Bank is authorised to charge 4% per annum mark-up on loans to project growers to meet running costs. In case of default, the ZTBL standard rate of 9% p.a. is applicable.
Supervised agriculture credit scheme
Under this scheme agriculture loans are given for short, medium and long term loans up to Rs.1 million per borrower/per case. The loans are sanctioned for inputs, tractors, agricultural machinery, tube-wells and irrigation facilities. Under the scheme, besides provision of credit, information is provided to farmers on farm planning, production, as well as guidance on implementation, marketing and repayment of loans.
Reference: www.ztbl.com.pk/lendingProducts.htm

Punjab Provincial Cooperative Bank Ltd. (PPCBL)

The Punjab Provincial Cooperative Bank Ltd. (PPCBL) is the only remaining provincial cooperative bank. Since 2001, PPCBL has also offered micro-finance services.

PPCBL provides Agricultural Production Loans on a short-term basis. The current lending rate is 14% per annum and 15% in case of default.

National Bank of Pakistan (NBP)

The National Bank of Pakistan (NBP) undertakes both public sector and commercial lending activities.

NBP has initiated a supported credit programme entitled *'I Feed The World'* which aims to assist farmers to *maximise productivity while minimising input use*. The programme sets out to establish 'role model' farms for other farms and farmers to follow.

NBP aims to provide farmers with an integrated package of credit with supplies of essential inputs, technical knowledge, and supervision of farming. It offers medium-term financing for watercourse improvement, tube-wells, farm power development, tea plantation, fencing, solar energy and equipment for sprinklers. NBP also provides loans for land improvement, equipment and livestock ranging from three months to one year on a renewal basis. In addition, short-term production loans are offered for basic farm inputs like seeds, fertilisers and sprayers.

Commercial banks

Forms of commercial agricultural credit in Pakistan
Production loans
Production loans are granted for the purchase of agricultural inputs such as seeds, fertilisers, pesticides, animal feeds, chicken medicines, water facilities, electricity for tube-well operation, labour, fuel and ice for marine fisheries. These are short-term loans, recoverable within two years.
Development loans
Development loans are provided for the purchase of tractors, installation of tube wells, pumping set, reapers, ridgers, cutter-binders, threshers, trolley, spray machinery as well as for irrigation, land development and storage. These loans are payable up to five years (medium-term) or even longer (long-term) depending on their classification.

Commercial banks operating in Pakistan are divided into four categories: Nationalised Commercial Banks (NCBs), Privatised Banks, Private Banks and Foreign Banks.

Overview of agricultural credit products from main commercial banks in Pakistan
Bank of Punjab (BoP) www.bop.com.pk
Bank of Punjab (BoP) is a scheduled commercial bank with majority of its branches in rural and semi-urban regions offering agricultural finance services. BoP eligibility criteria require the client to be a self-cultivator with up to 50 acres of farm land, or to be an owner-cum-tenant with at least five acres under cultivation. BoP finances 80% of the client's requirements, up to Rs. 500,000. Generally, repayment is required in equal biannual instalments over a period of five years. BoP offers the following agriculture finance schemes: • *Kissan Dost Agriculture Finance Scheme* provides loans for inputs (seeds, fertilisers, pesticides) • *Kissan Dost Tractor Finance Scheme* facilitates the purchase of tractors on a lease finance basis • *Kissan Dost Aabiari Scheme* allows for the purchase of tube wells • *Kissan Dost Mechanisation Scheme* finances the purchase of agricultural implements • *Kissan Dost Farm Transport Scheme* supports the purchase of farm transport vehicles
Habib Bank Limited (HBL) http://hblbd.com
HBL provides credit for both small and medium-size farmers. The bank has introduced the Haryali scheme for farmers, which offers revolving finance for three years. HBL's specialised agricultural finance department also assists farmers in modernising farming practices.
Faysal Bank Limited www.faysalbank.com
Faysal Bank offers flexible agricultural finance facilities. The loan amount depends on the farmer's needs, the type of business and the size of the farm. The bank encourages biannual repayments for cotton loans.
Askari Commercial Bank Limited www.askaribank.com.pk
Askari Bank offers numerous packages for agricultural finance: • Kissan agriculture finance provides a variety of credit options, renewable after three years • Askari Kissan Ever Green Agriculture Finance is designed to meet short-term input requirements • Kissan Tractor Finance is available for a period of five years • Kissan Aabpashi Finance facilitates installation of tube wells, water management equipment and water channel development • Kissan Farm Mechanisation Finance for farm modernisation.
Bank Alfalah Limited www.bankalfalah.com
Bank Alfalah's agri-finance programme (Zarie Sahulat) covers financing for activities related to crop production, harvesting, transportation, marketing, storage, processing, packing, export, development, working capital and fixed investment financing of non-crop activities and storage. Alfalah's other credit schemes include short- and medium-term financing for equipment, irrigation and tractor investments.

Microfinance sector

The microfinance[4] sector in Pakistan has its roots in donor-funded rural development projects. In particular, the Aga Khan Rural Support Programme's development model has been replicated all across Pakistan.

The microfinance landscape in Pakistan has changed considerably in recent years. This
change can be credited primarily to the government's growing interest in the microfinance sector. The objectives and strategy for the state's microfinance policy were summarised in 2000 under the Microfinance Sector Development Program (MSDP) which provide for several initiatives:

- the Microfinance Institutions Ordinance (MIO) of 2001 which provides the regulatory focus for the microfinance sector
- the development of public-private partnerships in microfinance (eg Khushhali Bank)
- the restructuring of a number of finance institutions (eg Agriculture Development Bank re-launched as ZBTL)
- the launch of several donor initiatives supporting microfinance wholesaling (such as the World Bank-supported Pakistan Poverty Alleviation Fund); retailing (such as Khushhali Bank, First Microfinance Bank and Kashf); training and capacity development; information (such as the Financial Sector Strengthening Programme) and communications (including the Pakistan Microfinance Network)
- the launch of four donor-supported funds that were aimed at supporting community-based social mobilisation, and at risk management.

In 2006, eight development agencies requested CGAP to conduct a review of the effectiveness of funders' support to microfinance in Pakistan. At the same time, the governor of the State Bank of Pakistan (SBP), the central bank, asked CGAP for assistance in developing a strategy for the SBP to expand microfinance. Therefore, CGAP decided to combine its aid effectiveness and policy diagnostic methodologies in Pakistan. The report's recommendations are summarised below:

CGAP CLEAR / Policy Diagnostic recommendations for Pakistan
1. *Insist on sustainability*. Funders must not encourage institutions to pass funding subsidy through to clients in the form of below-market interest rates. They should support specialized microfinance providers and insist on full cost-recovery interest rates in their funding agreements with microfinance providers.
2. *Encourage innovation, new actors, and new approaches*. Funders should create an international tender to attract experienced microfinance players (to build greenfield banks, for example) and support technological innovations, such as mobile phone-based financial services.
3. *Promote a commercial wholesale market*. Donors who fund the Pakistan Poverty Alleviation Fund's microfinance activities should consider whether and how to provide fresh funds for the microfinance

[4] The term 'microfinance' has been used interchangeably with 'microcredit' in Pakistan, largely because other services and products in the sector have been far less developed than credit. Savings and insurance, for example, are still in their infancy as far as their provision by microfinance institutions is concerned, and even some microfinance banks have been slow to evolve their savings instruments and potential. Debate about microfinance in Pakistan continues to be largely about microcredit.

component. They should help PPAF spin-off its microfinance lending operations while developing incentives for commercial banks to lend to microfinance providers.

4. *Diversify use of funding instruments*. Funding agencies (private and public) should spend more money on capacity building rather than funding large credit lines through government. They should adapt to market needs by offering a palette of instruments, with a focus on those that provide incentives for savings mobilisation.

5. *Create a joint technical assistance facility*. During the take-off phase of microfinance, donors should make high-quality, flexible, and demand-driven technical assistance available, possibly through a joint facility.

6. *State Bank of Pakistan should focus on regulation and supervision as a core role*. SBP is the government agency in Pakistan with the most knowledge about microfinance. It has a specific mandate regarding regulation and supervision. It should focus on this core mandate and function, while spreading good practice principles within the GoP.

7. *Delineate government's appropriate role as facilitator*. The GoP has a crucial role to play as a protector and a promoter of microfinance, but it should not provide microcredit directly to clients.

Reference: Country-Level Effectiveness and Accountability Review (CLEAR) with a Policy Diagnostic: Pakistan, Consultative Group to Assist the Poor (CGAP), 2007

Recently the European Union (EU), under the Pakistan Financial Services Sector Reform (PFSSR) Program, commissioned a study to assess the social impact of the country's microfinance programme (Zaidi et al, 2007)[5]. The study broadly reflected the results of the CGAP review in terms of recommendations.

The Government of Pakistan has recently formulated a financial inclusion strategy to transform microfinance coverage from 1 million to 3 million clients by 2010, offering millions more the opportunity to move out of poverty. The number of people in Pakistan accessing microfinance has increased by 85% over the last three years.

Micro-Finance Institutions (MFIs)

The Pakistan Poverty Alleviation Fund (PPAF), the National Rural Support Programme (NRSP), the Provincial Rural Support Programmes (PRSPs), as well as the First MicroFinance Bank, provide microfinance for micro-level enterprises and for the self-employed. Alongside providing finance for social welfare purposes, some RSPs and NGOs have begun extending credit to farmers to support their means of income and helping them secure larger profits and hence better livelihoods.

Rural Support Programme Network (RSPN)

www.rspn.org

The RSPN, a combination of ten Rural Support Programmes (RSPs), constitutes the largest non-government rural development agency in Pakistan. It facilitates RSPs in reducing poverty and improving sustainable livelihoods of the rural men and women in the country through actively involving these poor communities in their development programmes and offering feasible means to acquire basic needs.

RSPN's members are Aga Khan Rural Support Programme (AKRSP), National Rural Support Programme (NRSP), Baluchistan Rural Support Programme, Punjab Rural

[5] Zaidi, S. Akbar et al (2007), "Social Impact Assessment of Microfinance Programmes," Report submitted to the European Union-Pakistan Financial Services Sector Reform Programme, Islamabad

Support Programme, Ghazi Barotha Taraqiati Idara (GBTI), Sarhad Rural Support Programme, Khushhali bank, Sindh Graduate Association (SGA,) Lachi Poverty Reduction Programme and Thardeep Rural Development Programme (TRDP).

An individual qualifies for an RSP loan if s/he is a member of a Community Organisation (CO). To facilitate the poor in acquiring RSP loans, Social Organisations assist in identifying poor and the poorest households so that these can be integrated into the COs. All households in a CO can obtain an RSP loan by presenting a written recommendation of 80% of the CO members, a clear credit record and the capacity to manage the proposed activity. In addition, the grower should have attended at least three CO meetings.

RSPs' credit package for seeds, fertilisers, agro-chemicals, feed /fodder and working capital offers a first-time loan amount of Rs. 10,000 which increases incrementally by Rs. 5,000 with each successive loan taken. The credit period can go up to 12 months but the first loan has to be repaid within six months. Repayment can be made in monthly instalments or the whole amount can be paid back.

For the purposes of the BCI Producer Organisation Enabling Mechanism, note that RSPN published in 2007 Scaling Up Community Organizations: A Case Study Of Social Mobilization Best-Practices.

Aga Khan Rural Support Programme (AKRSP)

www.akdn.org/pakistan.asp

Many of the methods employed elsewhere by Aga Khan agencies (AKDN), and replicated by other NGOs and governments, were tried first and then refined in Pakistan. AKDN's earliest coordinated area development programme included community mobilisation, infrastructure development, microfinance lending and savings, and agricultural programmes. Activities are largely concentrated in North West Frontier and Baltistan, under the aegis of the Aga Khan Rural Support Programme (AKRSP). AKRSP extends credit facilities to farmers at subsistence level. These farmers need nearly Rs. 250 as crop loan - an amount which cannot be easily extended and recovered to thousands of small-scale farmers by banks. Currently there are a thousand village organisations with nearly 90,000 members. The loan repayment rate on the loans has been around 98%.

National Rural Support Programme (NRSP)

www.nrsp.org.pk

NRSP is a non-governmental organisation originally set up with an endowment from the government. The immediate goal of NRSP is to foster a countrywide network of Community Organisations (COs) at the grassroots level and to enable the less privileged to plan, manage and implement their development plans on their own. This strategy entails empowering communities to help themselves by mobilising people into COs and then providing guidance and technical skills through a CO forum. NRSP directly facilitated the formation of the Punjab Rural Support Programme

(PRSP), Ghazi Barotha Taraqiati Idara (GBTI), Khushhali Bank and the Sindh Rural Support Organization (SRSO).

NRSP's core activities are training, support to institutions, micro-credit, infrastructure development, and natural resource management:

- NRSP collaborated with the ILO on a project to liberate bonded labourers in Hyderabad (ILO PEBLISA/PEBLIP)
- NRSP also has a partnership with the Pakistan Poverty Alleviation Fund, whereby PPAF matches a Community Organisation contribution to investment in community physical infrastructure on the ratio of 4:1.
- In other agricultural sectors, NRSP has also undertaken the 'Sugarcane Productivity Enhancement Project', with private sector partners, aiming to facilitate small landholders in growing more sugarcane per acre, to increase its value, to reduce production costs and increase the profits earned by the farmers
- NRSP has an Environment and Natural Resource Management (ENRM) programme focused on improving soil quality, reducing farmers' losses, adding value to inputs and increasing productivity and profitability

PPAF

www.ppaf.org.pk

The Pakistan Poverty Alleviation Fund (PPAF) was established in 1997 as a not-for-profit
private company sponsored by the Government of Pakistan and funded by the World Bank. Under the terms of funding, 50% of World Bank funds must be used for microcredit and enterprise development. As a so-called 'apex fund', PPAF disburses soft loans (ie below-market rate) to a myriad of microfinance organisations in Pakistan. It also provides grants on a cost-sharing basis for development of small-scale community infrastructure, and strengthens development and microfinance institutions by supporting their capacity building activities. PPAF works throughout all the provinces of Pakistan.

Kashf Foundation

www.kashf.org

Kashf's mission is to alleviate poverty by providing quality and cost effective microfinance services to low income households, especially women, in order to enhance their economic role and decision-making capacity. Kashf operates mainly in Punjab and provides various loan and insurance services.

To determine the eligibility of the clients, they search for authenticity of the loan demander, investigating the loan utilising abilities of the borrower and his/her ability to repay the loan in the stipulated time. Their loans are eligible for running businesses, with no associations with collaterals. The organisation supports group methodology and entertains 5-30 people jointly to provide the loan.

Kashf is supported, inter alia, by UK DFID. 'Lessons learned' from the experience of Kashf are summarised below:

Type of programme	Credit and savings for poor women; small loans; training and insurance
Beneficiaries	65,000 borrowers
Institutional Factors	NGO with low unit costs; focus is on enterprise development; Profitable (but not yet on an adjusted basis)
Sustainability	Slightly profitable and thus probably sustainable; relatively safe portfolio
Lessons and Observations	• Lending to women and starting in urban areas can enable a quick and profitable start-up • Scale up fast to achieve volume and profitability, but avoid excessive risk
Source: http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1177200597243/ruralgrowthandpovertyreduction.pdf	

First Microfinance Bank Ltd (FMFB)

www.mfb.com.pk

FMFB is the result of the transformation of the microfinance program of the Aga Khan Rural Support Program (AKRSP) into a separate, specialised microfinance bank. The main shareholders are the AKRSP (45.5%), the Aga Khan Fund for Economic Development (30.30%) and the IFC (24.2%). FMFB currently operates 21 branches, 7 being in the major urban centres of Rawalpindi, Karachi, Lahore, Hyderabad and Gwadar, and 14 in rural Northern areas. Given its focus outside the cotton belt, it is of marginal relevance to BCI, although IFC involvement should be noted.

NGOs and rural development programmes

During social scoping in 2007, several consultees suggested that BCI could fruitfully engage with grassroots-level rural development organisations and Rural Support Programmes (RSPs) in the cotton belt, including

- Jinnah Welfare Society (JWS) which is based in Punjab conducts integrated participatory development projects aimed at organisation, enhancing skills through capacity building and Micro Credit Enterprise & Development Programs. JWS target landless or small farmers, rural workers, artisans and micro entrepreneurs.
- DAMEN which works with marginalised communities in Punjab (Lahore, Shiekhupura, Kasur) through capacity building, microfinance and social sector programs
- SAFWCO (Sindh Agricultural and Forestry Workers' Coordinating Organization) which is a well-established NGO working with rural communities located in the Sindh province (districts of Sanghar, Hyderabad, Khairpur, Dadu and Jacobabad). SAFWCO participates in the Sindh Microfinance Network (SMN), which gathers sixteen microfinance providers in the province. SAFWCO provides loans for income generation purposes, with an emphasis on women. Loans range from Rs. 8,000 to Rs. 25,000 and are disbursed through community organisations (COs), in rural villages, and directly through solidarity groups in semi-urban and slum areas. Loans are made to groups of men and women, comprised of three to six individuals that have been operating for over a year. Credit Committees in rural villages screen the applicants and act as intermediaries. The saving programme includes monthly meetings used to collect savings, with a minimum voluntary contribution of Rs.20, and is operated through COs, which collect deposits, and manage the savings records and passbooks. Communities are also encouraged to utilise their savings through their village development organisation as internal lending. SAFWCO also collaborates with small NGOs, providing them with training in microcredit operations and loans.

Below are more detailed overviews of three organisations working in the cotton belt with activities which are particularly relevant to BCI's Access to Finance Enabling Mechanism, as well as other Enabling Mechanisms and Production Principles.

Thardeep Rural Development Programme (TRDP)

www.thardeep.org

Thardeep Rural Development Programme (TRDP) operates in the rural areas of Tharparkar, Mirpurkhas, Dadu and Khairpur Districts in Sindh province. TRDP organises communities and develops managerial and technical capacity. It also provides credit.

- *Micro Enterprise Development & Income Generation*: TRDP endeavours to overcome lack of access to working capital, lack of expertise to manage the cash and lack of information regarding market trends through provision of financial services along with technical assistance to low income women and men at the village level.

- *Social Mobilization & Capacity Building*: under this programme, TRDP helps the community organise themselves into Village Development Committees and organises training, both managerial and technical, to provide the community with skills, hence empowering them, with a special emphasis on the poor, women and children. The formation of committees involves a process of *identifying needs in sustainable land use, water and sanitation, education, primary health, saving and credit and income generation areas*.
- *Natural Resources Management*: Financial and technical assistance is provided to village organisations in developing approaches for sustainable land use and work on livestock disease prevention.
- *Health & Education and Integrating Child Labour*: TRDP engages in advocacy activities supporting the elimination of child labour and poverty and supports children's education projects which promote environmental protection.
- *Ground & Surface Water Management*: TRDP is working on three strategic options – developing physical infrastructure, promoting indigenous methods of utilising underground rechargeable water and developing tube wells exclusively for drinking purposes.

Narowal Rural Development Programme (NRDP)

www.malianfoundation.org/mfcs/nrdp/index.html

Narowal is on the Punjabi border of Pakistan and India. The Narowal Rural Development Program (NRDP) provides services to rural poor communities in micro enterprise development, health, non-formal education, women's rights and empowerment, human and institutional development and livestock and agriculture. NRDP is recognised by international agencies – including ILO and Plan International – as an effective organisation and its range of activities provide a good fit with the BCI scope, particularly:

- *NRDP's Micro-Enterprise Development* programme, which focuses on socio-economic issues, providing skills development training and small loans for micro enterprise development using a group-lending methodology.
- *NRDP Health Programme*, focusing on mother & child health, reproductive health, nutrition, HIV/AIDs, basic health education and health/hygiene issues
- *NRDP Non-Formal Education Programme* focuses on primary education and functional literacy through providing primary education to girls and boys, functional literacy to illiterate young girls/women and teacher training.
- *NRDP Women Rights & Empowerment Programme* focusing on women's rights and empowerment issues, including gender discrimination and women's participation in decision-making processes at all levels
- *NRDP Human and Institution Development* focusing on human resource development and empowerment issues through formation and strengthening of men's and women's organisations at village level

- *NRDP Livestock and Agriculture Program*me, which provides small loans to poor farmers, development of agricultural extension workers at village level, training of farmers, workshops on various issues, and farmer CBOs development.

NRDP receives EC support to promote women's rights and is also currently participating in the ILO Social Finance Programme action-research project on Decent Work and microfinance.

Informal providers

Traditionally, friends and relatives, village shopkeepers, traders and commission agents have been a major source of agricultural credit in Pakistan. These sources generally lend for short periods and charge a high rate of interest. Such loans are given to tide over bad periods and as such are meant for consumption purposes. Loans are also made available for buying seasonal inputs where cash is essential. These sources are both inadequate and unreliable. No comprehensive data are available on the amount of credit advanced by informal credit sources.

As such it is difficult to find solid evidence regarding the relative share of these sources in the total credit supply. However, a few reports and some other rough estimates show that the formal credit sources have been able to meet only 50% of the total credit requirements of the farm sector and it may be assumed that the rest are met by informal sources of credit (Irfan et al, 1999)[6]. According to Irfan et al (1999), interest rates tend to vary from product to product and also by type of borrower as well as lender. On average, interest is estimated to be 25%. In the case of fertilizer it is 29% while for pesticides it is around 35%. The high mark-up charged on pesticides sold on credit is mostly due, according to Irfan et al, "*to a rather unholy alliance between the manufacturers and traders/dealers*". The case studies suggest that pure money lending is on the rise with quite exploitative interest rates ranging from 48% to 120% per year.

Informal credit sources however are still popular, particularly among small farmers, because of easy access, the fact that no documentation or collateral is required and availability of credit in time.

[6] Irfan M., G. M. Arif, S. M. Ali and H. Nazli, 'The Structure of Informal Credit Market in Pakistan', Research Report No. 168, PIDE, Islamabad. 1999

III. The role of multilateral agencies and development assistance

Links to finance and agriculture projects of the principal multilateral and bilateral donors are provided at Annex 2. What follows is a brief overview of the most pertinent development assistance activities relating to access to finance for cotton producer communities.

Asian Development Bank (ADB)

The ADB operates in Pakistan in a variety of capacities, providing soft loans to the government as well as technical assistance grants implemented by a diversity of partners. The first ADB stand-alone microfinance initiative was the Microfinance Sector Development Program (MSDP) launched in 2001 and implemented by the Pakistani Poverty Alleviation Program (PPAF). In 2003, ADB initiated the Rural Finance Sector Development Program, implemented by the Ministry of Finance, which included two loans to support the institutional strengthening of ZBTL, the State Bank of Pakistan and the project management unit at the Ministry of Finance.

ADB recently administered a policy reform project funded by DFID (USD1m), addressing access to credit for rural households[7].

IFAD

IFAD's major project on access to rural finance in Pakistan is the 'Microfinance Innovation and Outreach Programme' which started in 2006 and will provide support until 2011. Project funding takes the form of a loan of US$ 26,456,000.

The objective of this programme is to improve and increase poor people's access to a wide range of financial services and products. The programme is an integral part of the credit and enterprise development programme of the Pakistan Poverty Alleviation Fund (PPAF – see below) and concentrates exclusively on rural areas and poor communities, targeting small farmers and livestock owners, traders and micro-entrepreneurs, and particularly women and households headed by women.

World Bank

World Bank – Pakistan – 'Facts on Promoting Rural Growth and Poverty Reduction'
• Around 35 million people in rural areas are poor, representing about 80% of Pakistan's poor.
• Agriculture accounts for about 40 percent of rural household incomes.
• The majority of the rural poor in Pakistan ***are not farmers***.
• Access to credit and usable water is unbalanced.
• 37% of rural households own land
Source: http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1177200597243/ruralgrowthandpovertyreduction.pdf

The World Bank is the main funder of the Pakistan Poverty Alleviation Fund (PPAF – see above) which has provided micro-credit loans to more than 275,000 borrowers,

[7] www.adb.org/Documents/Profiles/PPTA/36343022.ASP

of whom 45% are women. The repayment rate for these loans is 100%. The Fund has also financed more than 3,400 local infrastructure projects from building wells to paving small roads. In areas where the Fund has been active, family incomes and consumption significantly increased. Personal and business assets have improved, as has the social status of the borrowers, especially women.

In 2007, the World Bank published a report on Promoting Rural Growth and Poverty Reduction in Pakistan. The report provides an overview of the major 'social mobilisation' programmes in Pakistan[8]. Other direct interventions aimed at improving welfare of the poor are also examined, including micro-credit programs, safety nets and programmes targeted at disadvantaged groups, particularly heavily indebted labourers.

Of particular pertinence to BCI, the Report recommends 'Avoiding the Error of the Add-on Credit Component'. According to the report, the evidence shows that *'microfinance needs a financially sound and sustainable institutional home to enable effective management. It should not simply be added as a component to a community development project. [...] Add-on credit components have been a feature of some Pakistan CDDs. There are some partial successes such as AKRSP's credit component but this did not reach profitability despite the institution having substantial skills.'*

IFC

Pakistan comes under the aegis of the IFC Middle East and North Africa (MENA) regional team. The IFC PEP Microfinance Programme for the MENA region aims at supporting the growth and development of a sound microfinance industry. The program's assistance to the microfinance industry is market-based and seeks to promote commercially sustainable microfinance institutions that can offer low-income clients an ever-increasing range of financial services.

The programme also supports the start-up of greenfield microfinance institutions. For instance, IFC co-financed the start-up of First Microfinance (FMBP) and helped establish Tameer Bank through an initial investment of $5 million. Tameer Bank is currently receiving capacity building assistance from IFC PEP-MENA, primarily in the areas of IT design and implementation, training and new products development (mobile phone banking and rural products).

The IFC A2F Performance-Based Grant Initiative Programme supports NRSP (see above) and FMBP (see above).

UK DFID

DFID supports various microfinance and financial strengthening initiatives in Pakistan. Of particular interest is the project initiated under the terms of its Financial

[8] Including discussion of farmers' associations and water users' associations relevant to BCI Enabling Mechanisms and Production Principles

Deepening Challenge Fund (FDCF), whereby DFID is supporting a project[9] led by Standard Chartered to provide an 'Agricultural Credit Card' to some 10,000 small farmers so they can buy seed, fertiliser and pesticides at collaborating stores and pay off the debt after the harvest. The project commenced in 2003 and is co-funded by FDCF (GBP 800,000 – 40%) and Union Bank Ltd (GBP 1,366,000 – 60%).

The Agricultural Credit Card provides working capital loans to farmers with between 12.5 and 50 acres. Interest rates of 24 percent apply and loans are repayable within 30 to 45 days of harvest and collected by the bank's collection agency. The bank is also introducing a community lending scheme where groups of 10-20 farmers guarantee the loans of group members. The Agha Khan Rural Support Programme is ensuring that these schemes are properly explained and proper procedures for running the groups are in place.

The use of card technology for seasonal agricultural lending is innovative in Pakistan. The links with suppliers in this scheme are new, as is the margin sharing agreement where about 15% of the manufacturer's margin is set aside for crop insurance and loan loss provision.

USAID

Since 2003, USAID's US$70 million Economic Growth Programme has focused on expanding access to credit, improving the competitiveness of Pakistani small and medium enterprises (SMEs) and improving agricultural practices. This includes ongoing projects on:

- 'Agriculture Growth and Employment / Increased Access to Microfinance' (starting 2005 and ongoing; US$ 6,007,000 grant-funding)
- 'Developing Financial Services for Communities without Credit' (September 2003 - September 2010; US$11,052,588 funding): this programme works with Khushhali Bank in Balochistan, FATA and Sindh and has disbursed 356,361 loans totaling more than US$ 63 million

Until 2005, USAID's Widening Harmonized Access to Microfinance (WHAM) programme provided consultancy, training and technology to commercial banks and microfinance institutions to establish products and business lines to meet the needs of micro, small and medium enterprises. WHAM also worked closely with the Pakistan Microfinance Network (PMN), and helped the National Bank of Pakistan, Standard Chartered Bank, First Microfinance Bank, Tameer Microfinance Bank, Asasah and the Kashf Foundation disburse loans totalling more than $57 million.

ILO

Starting in June 2000, the ILO began piloting microfinance-led schemes in Pakistan (see Decent Work promotion practices review). The ILO objective in deploying microfinance is to pilot cost-effective models of development interventions to solve bonded labour situations. The ILO work also seeks to increase the capacity of the

[9] www.financialdeepening.org/default.asp?id=685&ver=1

trade unions, employers' associations, law enforcement and other agencies to tackle the issue. ILO field-tests microfinance-led models for the rehabilitation of bonded labourers. The creation of 'bonded labour-free zones' in selected areas provides the organising framework for activities at field-level.

In Sindh province, a model has been tested for the release and rehabilitation of bonded *haris* (agricultural sharecroppers). This model involved transit camps for the provision of protection and immediate relief, a permanent settlement (to be provided on a lease basis), bridging education for children, and health support (both preventive and curative). The project was jointly managed by the ILO Social Finance Programme and the Special Action Programme against Forced Labour (SAP-FL). Other partners include the National Rural Support Programme (NRSP) and the Ministry of Labour. The Programme has been extended – as PEBLIP – with Dutch donor support since 2005 (see Decent Work promotion practices review).

Swiss Agency for Development and Cooperation (SDC)

SDC's activities in Pakistan are structured on two axes:

- Improving governance, with emphasis on strengthening decentralisation and local governance as well as improving the rights of women and children (eg Women Law and Status Programme; Combating Child Labour).
- Increasing income by improving the management of natural resources of the poor and strengthening capacities in the emerging microfinance sector (e.g. Community Based Sustainable Resource Management Programme; State Bank Partnership for Microfinance; Financial Sector Strengthening Programme).

SDC has supported the development of microfinance programs run by commercial banks (First Women Bank, Bank of Khyber) and other microfinance providers (Orangi, Kashf, Thardeep).

IV. Access to finance for cotton smallholders in Pakistan

Stakeholder views

The majority of social stakeholders consulted by BCI in 2007 considered financing to be an important determinant of livelihoods in cotton-producing communities. However some stakeholders felt that:

- this was not the area where BCI could have most effect, and looking to influence value chain actors – particularly pesticide retailers and cotton purchasers (ie ginners and spinners) – and promote producer organisation and better agricultural practices may be more effective
- finance is only an issue at one point during the cycle – namely around 5 months in, where further inputs may be needed
- pesticide expenditure may not be the key input overhead for cotton farmers; it can be argued that water represents a greater overhead

Most consultees agreed, however, that the key issues relating to input finance – namely, the provision of credit to purchase pesticides and fertiliser – are farmer indebtedness and the limited number of finance options.

Farmer indebtedness

Indebtedness occurs primarily because of sub-market prices paid to cotton farmers, late payment and the terms of finance itself. The key determinants of prices paid to (smaller) farmers for seed cotton are, in summary:

- International market prices
- Local market factors – shortages and over-supply
- Role of Government cotton support price (and 'Clean Cotton' premium)
- Relative bargaining power of farmers, vis-à-vis marketing agents and ginners, and commission paid by farmers to agents
- Additional overheads such as transportation
- Quality concerns and determinants of value (predominance of weight as value determinant)

In its value chain analysis, the World Bank (2006)[10] notes that one of the main inefficiencies in the cotton value chain is that hand-picked cotton is priced according to weight without considerations of enhanced quality gained through drying and cleaning. Therefore, the market prices adjust to account for lint contamination, and ginners and ultimately farmers, receive lower valuations for cotton than they would if quality considerations were addressed at the picking and ginning stage. Moreover,

[10] 'Pakistan: Growth and Export Competitiveness', Report No. 35499 – PK, Poverty Reduction and Economic Management, Sector Unit South Asia Region, World Bank, April 25, 2006 pp.32-49 www.worldbank.org.pk/external/default/main?pagePK=51187349&piPK=51189435&theSitePK=293052&menuPK=64187510&searchMenuPK=293080&theSitePK=293052&entityID=000012009_20060523095241&searchMenuPK=293080&theSitePK=293052

there is a direct – if not causal – link between prices paid to farmers and wage levels paid to pickers and other labourers employed during the cultivation cycle.

The Government has instigated a 'Clean Cotton' initiative to address contamination, which is a serious problem in Pakistan: as noted above, it has been observed that trash is frequently actively collected due to the fact that cotton seed is priced on weight and variety rather than a grading or valuation standard. Paying pickers by weight alone also militates toward picking trashy/damp – and therefore heavier – cotton. Moreover, where payment to pickers is made in kind, this entails that the cotton is itself exposed to a greater variety of contaminants between field and market (eg in the home of the picker).

Under the 'Clean Cotton' initiative, provincial government agriculture departments pay a premium of Rs. 50 per maund (40kg) to growers picking contamination-free cotton. Due to financing constraints, the Government is now considering imposing a levy on ginners of Rs. 5 per maund in order to continue paying the 'Clean Cotton' premium. This has not been positively received by the Pakistan Cotton Ginners Association (PCGA).

With regard to farmgate revenues, market prices at Dec. 2008 are summarised below:

Average retail prices of cotton in Pakistan, December 2008 (Rs. / Unit)

	Unit	Punjab	Sindh	NWFP	Balochistan	Year-on-year increase
Cotton lint	40kg	2808	2988	2750	-	-0.3%
Seed cotton (phutti)	40kg	1248	1378	1150	-	-3.9%

Source: ZTBL Agri-Business Field Report, Dec 2008 www.ztbl.com.pk/Documents/Publication/pkatglance08.pdf

Finance options

Institutional sources

As noted above, banks have numerous schemes offering credit services to the farming sector. Farm credit is provided for the purchase of tractors, tube-wells and farm machinery as well as for land improvement purposes. Applicants are required to meet a series of creditworthiness requirements.

A tale of two provinces: Punjab and Sindh

There is broad agreement that, due to limited financial resources and informal credit schemes with high repayment rates (40-50% per annum), many cotton farmers in Pakistan struggle to maximise productivity and a substantial proportion are trapped in debt. What needs to be factored into this picture is the fact that, according to government sources[11], the province of Punjab is responsible for ***80%*** of the uptake of all (institutional) agricultural credit extended to farmers.

This may be due in part to the role played by ginners and traders in providing input pre-finance to farmers in Sindh. In Sindh, it is established practice that general agricultural traders (*padhys*) based in

[11] www.sbp.org.pk/sbp_bsc/BSC/DFSD/Workshop/Agriculture-Department-Sindh_files/frame.htm

district towns or large villages provide seasonal production credit in kind (fertiliser, chemicals) and cash, plus some consumption credit, to cotton-producing, land-owning farmers (*zamindars*)[12]. The loans are repaid at harvest through deductions from sales revenue. Under the unwritten contract, a *zamindar* agrees to sell his seed cotton to the *padhy* who provides him with seasonal credit, but the price of the seed cotton is not negotiated until harvest, when it is based on prevailing market rates. *Padhys* provide credit to *zamindars* to maximise the volume of seed cotton that they handle at harvest time.

Indeed, historically it has been noted that, in the Sindh cotton sector, more competition amongst buyers led to a tighter supply market, and credit was the only way to ensure availability of supply from farmers (Smith et al, 1999)[13]. Indeed, it has been noted that gins have in the past offered **0% interest input credit** (so-called *cabaro contracts*) in order to ensure supply.

However, it is also observed in the Mirpurkhas district of Sindh that, at times of high-yielding crops, ginneries operated at full capacity and, as a consequence, many ceased to provide credit to their suppliers, as competing for scarce cotton supplies was no longer necessary (Stockbridge et al, 1998)[14].

SBP summarises the reasons for the low uptake of agricultural credit in Sindh as follows:

- Slow pace of issuance of Pass Book to the growers.
- Banks are reluctant to advance loans in calamity-affected areas.
- The documentation procedure is not simple.
- Awareness campaign to motivate farmers is lacking / very limited.

As a result of low levels of uptake of institutional finance, particularly in Sindh, the SBP organised an 'Inter Provincial Agricultural Work Shop Sharing Provincial Governments' Initiative and Best Practices in Farmers' Facilitation in June 2008. In particular, Sindh Agriculture Department plans to promote access to finance – and information about financing options – through the establishment of an 'Agro Service Center' at district level.

Reference: www.sbp.org.pk/sbp_bsc/BSC/DFSD/workshop.htm

A recent study[15] suggests, on the basis of primary research undertaken in Punjab (itself the province where 80% of institutional agricultural credit is taken up), a number of reasons why institutional credit is not applied for. Of the eight reasons listed, five were classified as reasons that affect the demand side, namely: do not need; involves paying bribe; inadequate collateral; private sources sufficient; and do not want to pay interest (potentially for religious reasons). The additional three reasons were categorised as affecting the supply side. These were: cumbersome procedure; lenders too far away; and expensive procedures.

The respondents were asked to cite the purpose of the loan taken. Among all the end-uses, agricultural production was found as 45%. It was followed by purchase of tractor 8.5%, purchase of land 6.1% with all others at less than 6%. The respondents were also asked about the formal institutions that they used for credit. The responses indicated that ZTBL was used in 86% of cases. The most important issue related to decision-making of the farmers relating to agricultural credit was the

12 See www.odi.org.uk/resources/specialist/natural-resource-perspectives/30-smallholders-liberalised-agricultural-marketing-systems.pdf

13 Smith, L., Stockbridge, M., and Lohano, H. (1999) "Facilitating the Provision of Farm Credit: The Role of Interlocking Transactions Between Traders and Zamindars in Crop Marketing Systems in Sindh", World Development 27(2), 403–418

14 Stockbridge, M.S. L., and H. R. Lohano (1998) "Cotton and Wheat Marketing and the Provision of Pre-harvest Services in Sindh Province, Pakistan," in Smallholder Cash Crop Production under Market Liberalisation: A New Institutional Economics Perspective, ed. by A. Dorward, J. Kydd, and C. Poulton, pp. 177–239. Oxon: CAB International

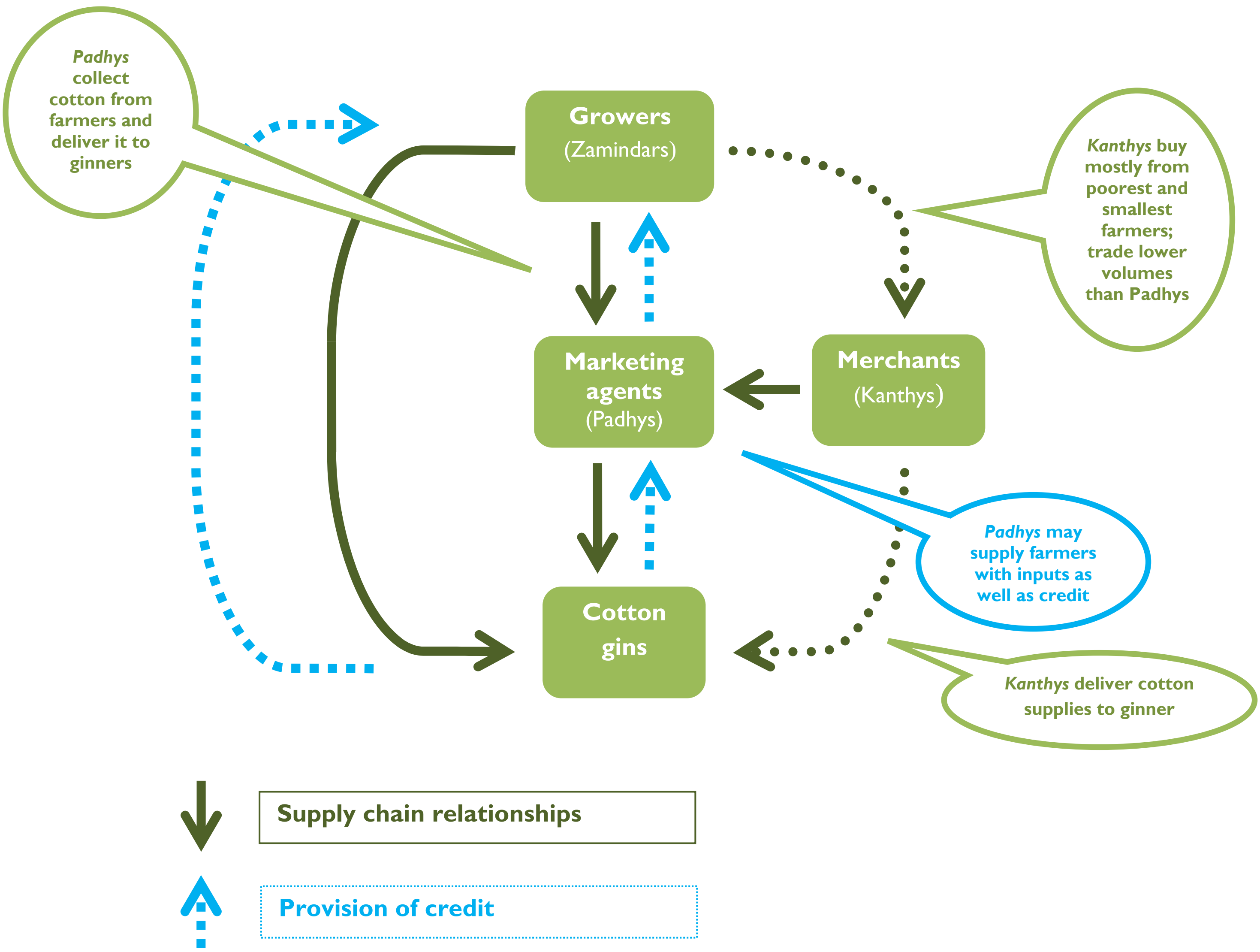
15 Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab, European Journal of Scientific Research, ISSN 1450-216X Vol.23 No.2 (2008), pp.294-304 www.eurojournals.com/ejsr_23_2_13.pdf

interest rate. The average interest rate was calculated as floating between 10% - 20%. The highest rate was in Punjab (20% pa).

Value chain finance and informal sources

In the context of the preceding overview of the predominantly institutional forms of finance for agricultural production in Pakistan, it should be understood that the *majority* of cotton cultivation – particularly in terms of input finance needs - continues to be financed by non-institutional sources.

Overview of cotton marketing chain – primary segments[16]



[16] Adapted from Stockbridge, M.S. L., and H. R. Lohano (1998) "Cotton and Wheat Marketing and the Provision of Pre-harvest Services in Sindh Province, Pakistan," in Smallholder Cash Crop Production under Market Liberalisation: A New Institutional Economics Perspective, ed. by A. Dorward, J. Kydd, and C. Poulton, pp. 177–239. Oxon: CAB International

Input and trader finance in Pakistani cotton – an overview

A. Input (pesticide) retailers as financiers

Marketing agents provide seasonal production credit in kind (fertiliser, chemicals) and cash, plus some consumption credit, to cotton-producing, landowning farmers. The loans are repaid at harvest through deductions from sales revenue.

B. Buying agents (padhy/kanthy) as financiers

The system of moving cotton from the farm to the ginner involves a sophisticated network of marketing and financing agents. (For the small farmer, a buying agent is generally a middleman between the farmer and the middleman; large farmers directly contact ginners, while marketing agents (*padhy wallahs*) are intermediaries between farmers and ginners.) Growers often receive inputs and finance for crop farming from the agents to whom farmers deliver their harvests. Due to lack of direct access to other capital, these marketing agents play a key role for the farmer. Under the unwritten contract, a landowner (or farmer) agrees to sell his seed cotton to the trader who provides him with seasonal credit, but the price of the seed cotton is not negotiated until harvest, when it is based on prevailing market rates. Traders provide credit to landlords to maximise the volume of seed cotton that they handle at harvest time. Some ginners provide credit to traders in return for seed cotton deliveries, so that they in turn can guarantee viable levels of capacity utilisation at their ginneries. There is a distinction in scale between *padhy wallahs* and *kanthy wallahs*:

- *Padhys* (traders): 'Padhy' refers to a shop where seed and farm produce are sold. Padhy wallah are usually referred to as commission agents or beopari. The term arthi is also sometimes used in Sindh as a synonym. Padhys dealing in cotton own the cotton they trade, and are subject to all of risks typically associated with ownership. The main function of a padhy is to link growers and ginners and arrange for transportation of cotton from farm to factory. Growers usually approach padhys when they want to sell their crop, rather than the other way round. In some cases, the 'padhy' acts as an (un)official agent or dealer for domestic fertiliser companies and imported pesticides.
- *Kanthy wallahs*: Kanthy wallah is a small-scale padhy who, unlike the padhy, is not involved in supplying inputs or credit. He collects small amount of cotton, which he sells either to a padhy, or more commonly direct to ginneries. Kanthys generally buy from growers; from hired labourers and from poor people, especially children who manage to scavenge small quantities from the road side or elsewhere. Kanthys do not themselves arrange for transport from the farm gate, their suppliers do this. They do, however arrange transport from their site to the factory.

C. Ginners as financiers

Ginners may provide credit to padhys and land-owning farmers. The main purpose of lending is to secure supplies. Loans are provided under what is called the 'cabaro contract'. This is a formal document in which the conditions of agreement are clearly laid down. The borrower is required to supply a quantity of seed cotton to the factory; usually an amount equal to one mound of seed cotton. Repayment of the loan is deducted from the amount paid to the borrower for the seed cotton supplied. The price paid for the delivery is the prevailing market price at the time of supply, unless supplier and ginners have entered into other arrangements for storage and delay of price determination as described below. The penalty to failing to meet the obligation to supply seed cotton is 5% per month interest charges on the outstanding loan. Factories also store cotton, either as unprocessed seed cotton or as lint.

This is not in itself problematic. In many instances, value chain players and other local actors are well-positioned to provide appropriate and responsive informal financial services to producer communities. It is problematic, however, in the widespread cases where the terms of finance and the absence of options induce a downward economic pressure on producer communities. This is a particular challenge for small-scale, tenant farmers (and this is why SBP directs agricultural lenders to focus 70% of loans toward 'subsistence' farmers).

Social stakeholders confirm that the terms of informal trader / input pre-finance may be as steep as 2% interest per week. The 'financing trap' is summarised in the newspaper article cited below:

Cotton producers victims of low price for seed-cotton and high prices for inputs

"This phenomenon in some part of Pakistan derives from kind of agreement between, in one hand ginners themselves and in the other hand ginners and traders. Ginners lend money to traders who use this money to buy inputs they resell on credit to farmers. Unfavorable prices to farmers result from this process. Government intervention is requested against the assumed agreement between ginners."

Source: 'Trader-factory owner nexus exploits cotton farmers', Malik Tahseen Raza, Dawn Nov. 19, 2007 www.dawn.com/2007/11/19/nat23.htm

However, even where there are other financing options – such as forms of institutional microfinance – ostensibly available to farmers, they will often not make use of this. Commonly, terms of microfinance entail that initial loans must be repaid before subsequent borrowing is permitted; further economic pressures on small farmers occur part-way in to the cycle, where infestation or other complications may occur, necessitating additional inputs (under conventional methods). However, if the farmer has already taken out a loan from a micro-lender, then further credit will not be available. Moreover, it is commonly the case that middlemen will issue credit chits for other needs not covered by micro-lending – such as basic foodstuffs and medicines.

Average farmers' cost of production of cotton in Punjab and Sindh, 2004–2005 crop year

	Summary of operations	*Punjab*		*Sindh*	
		Cost/Acre, Rs.	*Share, %*	*Cost/Acre, Rs.*	*Share, %*
1	Land preparation	1,018	7	1,220	10
2	Seed and sowing operations	628	4	862	7
3	Interculture and weeding	856	6	802	7
4	Irrigation	1,137	8	636	5
5	Labour for irrigation and water course cleaning	346	2	373	3
6	Plant protection (cost of pesticides, herbicides and application charges)	2,769	19	1,848	15
7	Manures and fertilizers including application	2,062	14	1,872	15
8	Mark up on farm investment (estimated at 14% per year on all costs incurred up to harvesting for eight months)	640	4	558	5
9	Management (for eight months)	330	2	330	3
10	Land rent (for eight months)	3,333	23	2,000	16
11	Land tax & drainage	80	1	149	1
12	Land revenue	5	0	5	0
13	Payments for picking	1,392	9	1,291	11
14	Harvesting of cotton sticks	185	1	285	2
15	**Gross cost of cultivation**	**14,783**	**100**	**12,232**	**100**
16	Value of cotton sticks	185		285	
17	Net cost of cultivation	14,598		11,947	
18	Seed cotton yield (kilograms/acre)	696		608	
19	Cost of seed-cotton at farm gate:	*Rs/40 kg*		*Rs/40 kg*	
	with land rent	839		786	
	without land rent	647		655	
20	Transport and marketing costs	18		20	
21	Cost of seed-cotton at market/gin:				
	with land rent	857		806	
	without land rent	665		675	

Source: Data adapted from APCOM Price Policy Report for Cotton 2004–2005 crop; cited in IFPRI (2008), p.44 www.ifpri.org/pubs/dp/IFPRIDP00800.pdf

V. Rural Finance Promotion Practices

Views of BCI social stakeholders in Pakistan
The majority of BCI social consultees in Pakistan (2007) considered financing to be an important determinant of rural livelihoods, and agreed that the key issues relating to input finance are farmer indebtedness and the limited number of finance options. However, some stakeholders expressed reservations, in particular:
• Historically, microfinance initiatives have failed to reach smaller farmers, nor is microfinance geared towards cotton farmers; at the moment access to finance is provided almost exclusively by middlemen, who are 'impossible to circumvent'
• Existing microfinance programmes – such as those offered by NRSP (National Rural Support Programme) to cotton farmers – were criticised as still relatively high interest products (18%) which the recipient does not necessarily have the knowledge to utilise.
• EC Finance Sector Reform Programme considered it vital that lending activities and capacity-building activities were kept distinct, lest the latter detract from the perceived importance of borrowers repaying the former.

Challenges and questions

Many of the developments and experiences in rural finance in Pakistan militate against a simple conversion into 'practices' or 'tools' for BCI.

- Increasingly, attention is moving toward the vital role of non-farm and off-farm activities in rural economies, and the financing needs. This raises the question, encountered in other BCI regions, of whether directly crop-related finance is the most apt means to meet the real and expressed financial needs of communities involved in growing cotton. Micro credit facilities are increasingly directed to rural non-farm households (rural poor, landless farmers/labourers and women)[17] – as the World Bank (2007) notes, the majority of the rural poor in Pakistan are not farmers[18]
- Furthermore, while the vast majority of experience in promoting access to finance in Pakistan has focused on credit provision (in part because RSPs have not been mandated to deposit savings), many of the experiences surveyed here suggest that credit is not the only financial need of rural communities, and crop insurance is an important need which is currently unmet[19]
- Where credit provision has been 'bolted-on' to rural / agricultural development programmes, this has not proven a sustainable strategy (World Bank, 2007): there is increasing focus on the sustainability of financial services themselves, and of the institutions that provide them[20]
- Group-lending methodologies, successful elsewhere in overcoming impediments to lending through absence of collateral, have experienced difficulties in Pakistan, in part due to socio-cultural factors inhibiting the development of cooperative

[17] Impact of Agriculture Credit on Growth and Poverty in Pakistan (Time Series Analysis Through Error Correction Model), European Journal of Scientific Research Vol.23 No.2 (2008) www.eurojournals.com/ejsr_23_2_07.pdf
[18] http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1177200597243/ruralgrowthandpovertyreduction.pdf
[19] www.dawn.com/2008/12/01/ebr5.htm
[20] http://siteresources.worldbank.org/PAKISTANEXTN/Resources/293051-1177200597243/ruralgrowthandpovertyreduction.pdf

associations[21], and in part due to the economic role of landowners (who may intervene 'on behalf of' tenant farmers)

Opportunities for BCI

It is clear that BCI will need to engage with government actors in Pakistan on all aspects of Better Cotton; this is no less the case for access to finance. This has the following implications:

- NRSP is an established national network promoting microfinance and technical guidance for producers as a means to increase agricultural profitability; as such NRSP is an important potential partner for BCI. NRSP can only engage with BCI given clear approval from senior federal-level actors.
- The ZTBL-MinFAL Crop Maximisation Project - and supervised credit scheme – are also state-led finance initiatives which are clearly relevant to BCI's broader aims.
- The State Bank Agricultural Credit Department (ACD) is the centre of policy and activities to support access to finance for farmers, and has in recent years focused increasing on a needs-based approach.
    i. ACD will likely be a useful resource in terms of developing needs assessment methodologies and interpolating existing data
    ii. ACD is also seeking to scale-up awareness-raising and capacity building activities around access to finance for small farmers
    iii. The regional agri-finance focus groups set up by the Development Finance Support Department of SBP will likely also be useful partners in understanding the financial needs of cotton farming communities and developing responses

The experience of WWF-Pakistan suggests that an important demand-side contribution to reducing indebtedness of cotton farmers can be found in promoting (IPM-based) approaches to reduce and rationalise input use and hence input material costs. On the supply-side, there are many organisations – recapped in 'NGOs and rural development programmes' above – already acting to provide access to finance in order to promote income generation opportunities for rural communities. In particular, the network of Rural Support Programmes and Rural Development Programmes undertake a series of support activities based around the concept of 'social mobilisation' (ie community organisation) which then provides a platform for lending, information dissemination, technical guidance and building business skills. This approach is wholly consistent with BCI's needs-based capacity building approach to working with smallholders.

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[21] Agricultural Credit Constraints and Borrowing Behavior of Farmers in Rural Punjab, European Journal of Scientific Research, ISSN 1450-216X Vol.23 No.2 (2008), pp.294-304 www.eurojournals.com/ejsr_23_2_13.pdf

Annex 1: International and bilateral assistance programmes relating to access to finance in Pakistan: links

Multilaterals

Asian Development Bank (ADB)
- Projects

European Commission
- Development cooperation
- Economic cooperation
- List of EU-Pakistan cooperation projects
- Summary of EU projects

Food and Agriculture Organization (FAO)
- Projects

Global Environment Facility (GEF)
- List of projects
- Projects, by topics

International Finance Corporation (IFC)
- Projects

OPEC Fund For International Development (OFID)
- Cumulative public sector loans

United Nations Development Programme (UNDP)
- Environment and energy: Ongoing projects
- Environment and energy: Pipeline projects
- Gender: Ongoing projects

World Bank (WB)
- Active projects
- Proposed projects

Bilaterals

Australian Development Agency (AUSAID)
- Project and programme details

Canadian International Development Agency (CIDA)
- Projects

Japan Bank For International Cooperation (JBIC)
- Project database

Japan International Cooperation Agency (JICA)
- Projects

Swiss Agency for Development and Cooperation (SDC)
- Projects

United States Agency For International Development (USAID)
- Economic growth

Non-governmental organizations (NGOs)

Oxfam Netherlands
- Projects (search, in Dutch)

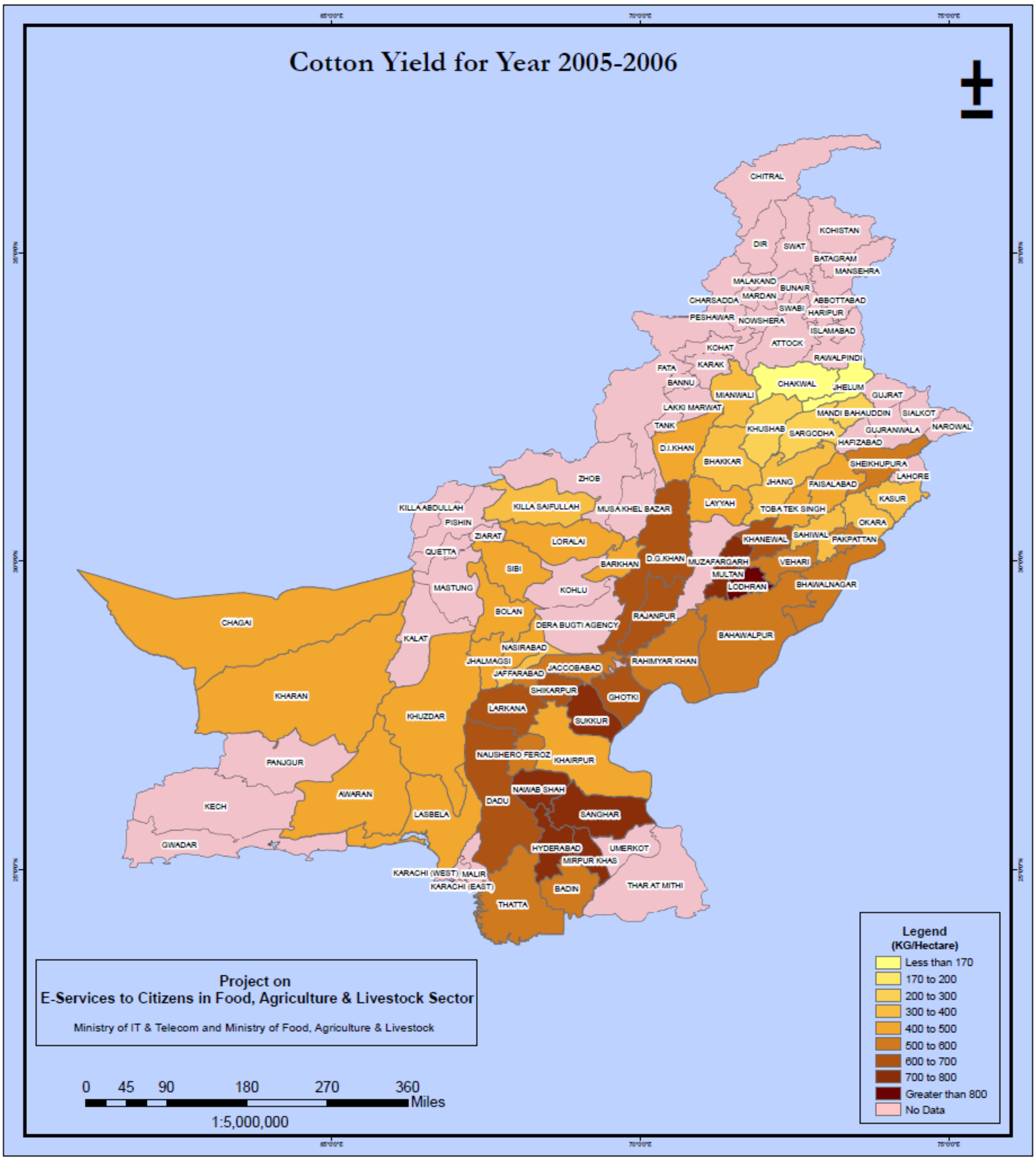
Research institutes

Australian Centre for International Agricultural Research (ACIAR)
- Current projects

International Food Policy Research Institute (IFPRI)
- Research programmes and projects

International Water Management Institute (IWMI)
- Country activities

Annex 11: Cotton-growing Districts in Pakistan



Glossary

ACD	State Bank (SBP) Agricultural Credit Department
ACO	Agricultural Census Organization
ADB	Asian Development Bank
ADBP	Agricultural Development Bank (now called Zarai Taraqiati Bank – ZTBL)
AKRSP	Aga Khan Rural Support Programme
CB	Commercial Bank
CIF	Community Investment Fund
CO	Community organization
CSP	Child Support Program
DCO	District Coordination Officer
DDO	Deputy District Office
DFI	Development finance institution
DFSD	State Bank (SBP) Development Finance Support Department
FO	Farmer Organization
KIBOR	Karachi Inter Bank Offered Rate
MINFAL	Ministry of Food, Agriculture and Livestock
MSDP	Microfinance Sector Development Program
NBP	National Bank of Pakistan
NRSP	National Rural Support Programme
NWFP	North West Frontier Province
PASSCO	Pakistan Agricultural Storage and Supplies Corporation
PBA	Pakistan Banks' Association
PEBLISA	ILO Project on Prevention and Elimination of Bonded Labour in South Asia
PIHS	Pakistan Integrated Household Survey
PPAF	Pakistan Poverty Alleviation Fund
PPCBL	Punjab Provincial Cooperative Bank Limited
Rs	Rupees
RSP	Rural Support Program
RSPN	Rural Support Program Network
SBP	State Bank of Pakistan
TCP	Trading Corporation of Pakistan
TPP	Tameer-e-Pakistan program
WUA	Water User Association
ZTBL	Zarai Taraqiati Bank Ltd (formerly Agricultural Development Bank – ADBP)