Pakistan Microfinance Network

RURAL FINANCE POLICY IN PAKISTAN

October, 2008

ITS SCOPE, SOURCES AND IMPLICATIONS FOR THE MICROFINANCE SECTOR

Commissioned by the
PAKISTAN MICROFINANCE NETWORK

The Pakistan Microfinance Network is an association of retail microfinance providers. Our vision is to extend the frontiers of formal financial services to all and mission is to support the sector, especially retail microfinance institutions to enhance scale, quality, diversity and sustainability in order to achieve inclusive financial services.

RURAL FINANCE POLICY IN PAKISTAN

ITS SCOPE, SOURCES AND IMPLICATIONS FOR THE MICROFINANCE SECTOR

First printed in 2009 in Pakistan

132, Street # 40, F-10/4, Islamabad, Pakistan.
Tel: +92 51 2292231, +92 51 2292270
Fax: +92 51 2292230
Email: info@pmn.org.pk
Website: www.microfinanceconnect.info

For further information, contact Sara Saeed Khan at sskhan@pmn.org.pk

Authorized by Sara Saeed Khan
Design and Layout by Zain Ali Shigri - Fifth Dimension (Pvt.) Limited

Contents

I. Background 01
- A. Introduction 01
- B. Methodology 01
- C. Definition of Rural Finance 01
  - (a) Rural Credit: 02
  - (b) Savings Mobilization: 02
  - (c) Insurance Services: 02
  - (d) Payment System: 02

II. History of Rural Finance Policy in Pakistan 03
- A. Overview 03
- B. The Pre-partition System 03
- C. The History of Agriculture Sector Lending in Pakistan 04
- D. Directed Lending 05
- E. A Market Oriented Approach 08
- F. Transforming Public Sector Infrastructure 09
- G. Adopting a Hybrid Approach 09

III. Sources of Rural Finance Policy 11
- A. State Bank of Pakistan 11
- B. Federal Government 13
- C. Role of Donors in Policy Making 14
- D. Role of Key Stakeholders 15

IV. Current Scope of Rural Finance Policy 17
- A. Overview 17
- B. Agricultural Credit Requirements 19
- C. Prudential Regulations for Agriculture Financing 20
- D. Financing Scheme for Small Farmers 21
- E. Guidelines for Livestock Financing 21
- F. Poultry Financing 23
- G. Horticulture Financing 23
- H. Fisheries Financing 24
- I. SME Financing 24
- J. Branchless Banking 24
- K. Branch Licensing Policy 25
- L. Crop Loan Insurance 25

V. The Impact of Rural Finance Policy 26

VI. Implications for the Microfinance Sector 29
- A. Policy Advocacy 29
- B. Institutional Growth and Development 30
- C. Operational Implications 30

Annexure 33
- Annex 1: References 33
- Annex 2: List of People Interviewed 34

Policy Annexure 35
- Policy Annex 1: Report on the ACAC July 2007 35
- Policy Annex 2: Report on the ACAC July 2007 – Performance 36
- Policy Annex 3: Time Line of Agriculture Finance Policy 38
- Policy Annex 4: Graphical Analysis of Bank’s Agricultural Credit Portfolio 40
- Policy Annex 5: Circulars Regarding the Supervised Agriculture Credit Scheme 45

List of Abbreviations 52

I. Background

A. INTRODUCTION

1. This paper has been commissioned by the Pakistan Microfinance Network to assess the state of rural finance policy in Pakistan. Over the years, there have been a number of initiatives with regard to rural finance at the government level. The central bank and the various government departments have long recognized the need to promote access to finance for rural markets in order to help them meet their financial needs and increase productivity. However, given the extent of interest in this area, there is confusion around how these initiatives synthesize and compliment each other. This paper is aimed at disentangling the different approaches and views within the public sector on rural finance to present a clear picture of the various initiatives and policies. This paper will present the sources and scope of this policy and try to identify the intended target markets and its impact. A key objective will be to assess the implications of the findings for the microfinance practitioners who are the primary clients for this research. In particular, it is expected that this paper will assist PMN in identifying areas where it can create synergies with the microfinance sector for making funds available for rural microfinance. This paper was commissioned in August 2008 and was prepared by Maliha H. Hussein.

B. METHODOLOGY

2. Policies which affect agricultural and rural finance belong to several different policy-making zones. Three in particular have a critical impact on rural finance policy, namely: agricultural sector policy, financial sector policy and macroeconomic policy. As such, one of the key tasks of this research was to try and identify the different strands of policy from these three domains which had a direct bearing on rural finance policy. A key finding was that there is no institutional home for rural finance policy even within an organization like the State Bank which has shown an outstanding leadership role in policy making for the financial in recent years. Within the SBP there is no composite repository of rural finance policy and documentation. Therefore, piecing the puzzle for a proper appreciation of rural finance policy was not easy. However, the search for policy documents was not as frenetic as it could have been mainly due to the web based information and communication system. The resource materials available on the official website of the State Bank of Pakistan, the Ministry of Finance and the Rural Finance Learning Center were reviewed along with other materials of interest for this study. A list of key references is given at Annex 1.

3. This paper is based on extensive discussions with the State Bank of Pakistan, Ministry of Finance, Ministry of Agriculture, the representatives of the Punjab Provincial Cooperative Bank, the Punjab Cooperatives Department, donor representatives involved in financing of the sector and key resource persons knowledgeable about formulation and implementation of rural finance policy in Pakistan. In addition, former staff members at the State Bank of Pakistan who were responsible for policy formulation were also interviewed. The list of people interviewed is given in Annex 2.

This paper is aimed at disentangling the different approaches and views within the public sector on rural finance to present a clear picture of the various initiatives and policies.

C. DEFINITION OF RURAL FINANCE

4. There is considerable confusion regarding the definition of rural finance in Pakistan. During the course of this analysis, one finding which was evident was that policy makers generally defined rural finance as if it was synonymous with agricultural finance or microfinance. There has not been much reflection on the scope of rural finance among policy makers. One exception to this was the broad view taken by the Committee on Rural Finance (CRF) constituted in 2002

to deliberate on rural finance issues in Pakistan. This Committee was constituted by the Governor as a special measure to deliberate on rural finance issues. It was a temporary arrangement and was disbanded after its report was presented to the Governor and Ministry of Finance. The CRF commented that rural finance did not only mean just agriculture credit or savings. The Committee on Rural Finance defined rural finance as encompassing the following;

(a) Rural Credit:

Agriculture credit will be the major component of rural credit but our definition includes the requirement of credit of all rural business and agricultural related activities including retailing-wholesale activity, rural SMEs (Small and Medium Enterprises), agriculture and livestock credit, forestry, fisheries and credit required for marketing rural produce, etc.

(b) Savings Mobilization:

Mobilization of rural savings is perhaps as important for accelerated agricultural and rural development as provision of credit. While policy efforts have been made on the credit side, very little attention seems to have been paid to this important component.

(c) Insurance Services:

Access to insurance for various risk mitigating purposes is an integral part of the finance sector and availability and penetration of insurance in the rural sector is an integral part of the rural finance market.

(d) Payment System:

The remittances, transfer and payment of funds form the last part of the CRF's definition of rural finance. The geographical dispersion and long distances between economic agents of the rural sector point to the importance of this component within the subject of rural finance.

5. While the focus of this review was on credit and savings, it also looked at current policy measures regarding the provision of insurance and payment systems.

II. History Of Rural Finance Policy In Pakistan

A. OVERVIEW

6. Rural finance policy in Pakistan has followed the broad contours determined for it by macro-economic policy. As noted in a recent publication which tried to examine the political economy of reform in Pakistan[1], when the country attained independence, most of the developing world was either a colony or behind the iron curtain. In this immediate post-war era, Keynesian policies of activist government were in force and the new Bretton Woods institutions began their mission of managing the world economy and eradicating poverty. Markets were regarded with mistrust and suspicion and Governments assumed a key role armed with new tools of planning and activist monetary policies. The combination of the external donor and government and a deep suspicion of the market led to the development of the planning model that formed the basis of Pakistan's economic policy for many decades[2]. In this planning model, the government took on more and more of the market and social functions in the economy. The policy of rural finance which was pursued in these early years was very much in keeping with this ethos which advocated government led planning and control.

7. A second key factor which impacted policy at this early stage was the emphasis that was placed on industrial production. Even though agricultural productivity increases were expected to finance a move to modernization and industry, focus on the agriculture sector was limited in scope. Pakistan had serious resource constraints as it was labour-abundant and capital-poor. Hence, it became necessary for the government to conserve its capital through capital controls as well as seek capital from overseas. At this stage, policy measures sought to boost production and exports through controls on the domestic market. For most of this period, resources were continuously transferred from the rural to the urban sector using policy measures which were biased in favour of industry. The terms of trade were kept against agriculture by keeping the procurement price of wheat well below the international price. At this juncture, there was no explicit rural finance policy which was aimed at providing resources to meet the overall needs of the rural areas. There were limited measures taken to provide access to farm credit.

8. The evolution and pattern of rural finance policy in Pakistan has generally followed the broad trends that have prevailed in the region and elsewhere in the world. The trend in Pakistan as in most developing countries has moved from a directed lending approach to a more market oriented approach. However, as is clear from a review of the evolution of rural finance policy in Pakistan, the trend is not a move in one direction but the policy has vacillated between directed lending and allowing the market to determine the parameters. Thus in Pakistan one has seen the emergence of a hybrid approach to rural finance. There are elements in the policy which tend to favour a market led approach but given the enormous task of dealing with poverty

> The policy of rural finance which was pursued in these early years was very much In keeping with this ethos which advocated government led planning and control.

alleviation and equity concerns, the government has always been nervous of letting the market determine the course entirely. As such, within a market led approach, many measures have been taken by Government to ensure that resources are directed to specific geographic areas, target groups and sectors of the economy. The principal means of ensuring this has been through setting up of mandatory targets for the agriculture sector, small-scale industry, and for special geographic areas, etc.

B. THE PRE-PARTITION SYSTEM

9. The small farmers and the landless have generally relied on informal sources for meeting most of their credit requirements. Prior to

1. Nadeem ul Haque. Beyond Mercantilism. 2006.
2. Nadeem ul Haque. Beyond Mercantilism. 2006.

independence, institutional credit was available to the farmers either in the form of Taccavi loans or from such co-operative societies as were functioning in the country at the time. Taccavi loans were initiated by Government before cooperatives and commercial banks actively came into crop and other agriculture sector loans. Taccavi loans were given from the government treasury and disbursed to needy farmers for seeds, fertilizers, etc. by revenue agencies. Taccavi loans were also given in the case of damage to crops in floods or famine conditions. Like all loans, Taccavi carried an element of interest, and in the case of a delay in repayment, penal interest was also levied. The formal sanction and regulation of Taccavi loans was established through the Land Improvement Loans Act of 1883 (LILA) and Agriculturists Loan Act 1884 (ALA), later on replaced by West Pakistan Agriculturists Loan Act of 1958 (ALA). Under LILA, loans were disbursed for sinking of irrigation wells/tubewells, land leveling, and land reclamation and development for agricultural purposes. Under ALA, loans were provided for relief of distress and for purchasing seed, fertiliser, cattle, and implements. Taccavi loans were disbursed through revenue departments of the provincial governments. The contribution of these loans towards total institutional credit declined overtime with the development of new institutional sources. Small amounts were allocated in provincial budgets for these loans. Moreover, delays and procedural difficulties in sanctioning and disbursement of loans rendered the system of Taccavi inefficient and ultimately these loans were discontinued in 1993-94[3].

10. The credit cooperatives have existed in this region since their introduction in India under the Cooperative Credit Societies Act of 1904. The objective was to provide loans to small farmers through their own local associations on relatively easy terms and free them from the exorbitant rates offered by moneylenders and grain merchants. The scope of cooperative activities was enlarged through the Cooperative Societies Act of 1912 to other fields besides agricultural credit to allow the use of the system in urban areas as well. The Act gave powers to Provincial Governments to make rules to carry out the purpose of the Act including the settlement of disputes among members and their societies by arbitration. Under the reforms of 1919, Cooperatives became a provincial subject and some of the provinces proceeded to enact their own laws relating to cooperative societies. The Government of Bombay passed Bombay Cooperative Societies Act of 1925 to replace the Central Act of 1912. The Act of 1925 was more stringent and enhanced the authority of the Registrar giving him the power to impose penalties on managing committees and their members for mismanagement. Punjab, NWFP, and Balochistan continued with the Act of 1912. The Cooperative Societies Act of 1925 was extended to the whole of present Pakistan during 1965. It is contended that cooperative credit had no formal relationship with the financing of inputs and/or farm investments. It was designed to compete with non-institutional sources of credit and was aimed generally to meet the credit needs of farmers to finance their consumption expenditures[4]. At the time of independence, the co-operative banks were engaged in financing commercial activities mainly and had neglected the financing of co-operative societies.

C. THE HISTORY OF AGRICULTURE SECTOR LENDING IN PAKISTAN

11. The focus on agriculture lending in Pakistan was made an integral part of the functions of the Central Bank. Section-8 (3) of the State Bank of Pakistan Act, 1956 states that the State Bank shall create a special Agricultural Credit Department with the following functions:

- To maintain an expert staff to study all questions of agricultural credit and be available for consultation by the Federal Government, Provincial Governments, Provincial Cooperative Banks and other banking organizations**, and**

3. Iqbal, M., Ahmad, M. and Abbas, Kalbe. 2003.
4. Qureshi and Shah. 1992.

- To co-ordinate the operations of the Bank in connection with agricultural credit and its relations with the Provincial Cooperative Banks and any other organizations engaged in the business of agricultural credit. Prior to 1972, commercial banks' lending to agriculture was nominal, and the bulk of credit to this sector was being provided by the Agricultural Development Bank of Pakistan (now ZTBL). With the introduction of Banking Reforms in 1972, several institutional and policy changes were made with the objective of more equitable istribution of bank credit.

12. In 1972 an Agricultural Loans Scheme was introduced. In the absence of adequately developed specialized institutions for this sector, commercial banks, with their large network of branches, were inducted for mandatory agricultural financing under this Scheme. The Agricultural Credit Advisory Committee (ACAC) in one of its meetings observed that the agricultural credit disbursed by Nationalized Commercial Banks (NCBs) was being diverted to non-agricultural purpose and the position of recovery of these loans was not satisfactory. The Committee felt that the solution of the problem lay in expansion of supervised credit scheme. It was decided that NCBs should, in future, disburse agricultural loans under a Model Scheme, which would be developed by Pakistan Banking Council. The Pakistan Banking Council, in consultation with NCBs and some agricultural credit experts, prepared a draft model scheme for agricultural credit. Under this scheme the Pakistan Banking Council was asked to allocate territorial jurisdictions to Nationalized Commercial Banks for implementing the Scheme. The allocation of territorial jurisdiction among the Nationalized Commercial Banks was made on tehsil-wise basis in consultation with banks. The Supervised Agricultural Credit Scheme was revamped significantly in April 2001 on the initiatives of commercial banks under the leadership of Muslim Commercial Bank Limited. It was decided to withdraw the restrictions on commercial banks for making disbursements only within their respective territorial jurisdictions. In August, 2001, under Section-25 of Banking Companies Ordinance 1962, fourteen new Domestic Private Banks were inducted in the Agricultural Loans Scheme and indicative targets were allocated to them for the year 2001-02.

D. DIRECTED LENDING

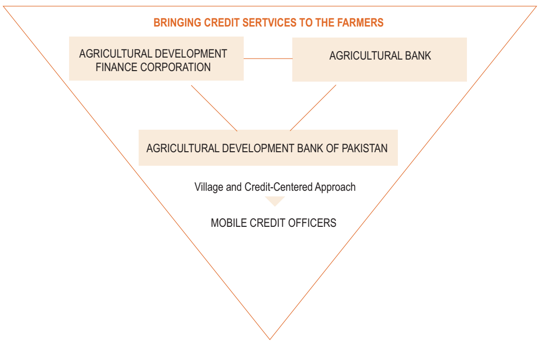
13. There is little mention of rural finance in policy making documents in Pakistan. The focus in the first phase was providing finance to the agriculture sector. After partition, the policy that was pursued to deliver agriculture credit relied on three main types of institutions (i) the Agriculture Development Bank of Pakistan, (ii) the Cooperative Banks, and (iii) Commercial Banks. The Government in a sense reinvented the Taccavi system by providing loans from its own sources to both the ADBP and the Cooperative Banks. Commercial banks were mandated to provide funds under threat of penalties. The ethos of this policy stemmed from a distrust of the market which could not be relied on its own to provide credit to the agriculture sector.

14. In the 1950s two specialized institutions namely the Agricultural Development Finance Corporation and the Agricultural Bank were established. These were merged to form the Agricultural Development Bank of Pakistan (ADBP) in 1961. Historically, ADBP has been used as a subsidy delivery vehicle by successive governments, lending to its clients at below market interest rates. The Bank introduced a village and client centered approach through the expansion of its supervised credit scheme by bringing credit services to the farmers through Mobile Credit Officers (MCOs) (see Figure 1). To provide access in rural areas, a country wide network of branches and MCOs was developed. ADBP also introduced services of female credit staff for the first time.[5] There was relaxation in lending conditions which had previously been based on mortgaging land and as a result had excluded tenants, landless and women from

5. PCR, Gujranwala Agriculture Development Project, Operations Monitoring & Evaluation Department, ADBP, October 1994.

accessing most credit lines.

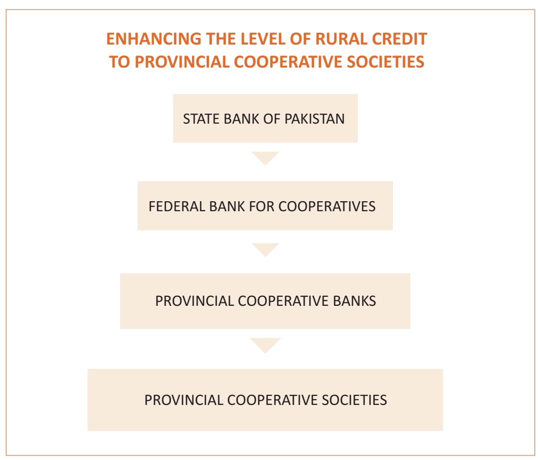
Figure 1: Emergence of the Agricultural Development Bank of Pakistan.



15. ADBP served between 150,000 to 200,000 clients annually prior to 1998. As 80 percent of ADBP loans were production loans recoverable in six months it was likely that regular ADBP clients were borrowing twice a year and were being double counted. The number dramatically increased from 145,671 in 1997 to 351,126 in 1998. This quantum jump was mainly due to the “One Window” agricultural credit operation organized by the Punjab Government, which considerably simplified the agricultural credit system by issuing Agricultural Passbooks and sanctioning loans in one day at one geographical location[6]. ADBP has been mostly run as just another Government Department rather than as a Bank with the Finance Ministry making decisions rather than the Board of Directors of ADBP. The ADBP was given highly subsidized funds by the State Bank of Pakistan (SBP). This gave it a large spread of around 11.1 percent[7]. However, provisioning and write offs consumed the entire profit generated from the interest the bank received from its current clients. By the end of 2002, ADBP had accrued huge defaults which are said to be anywhere from 30 percent[8] to 45 percent[9] of its total loan portfolio in the agriculture sector.

16. To further enhance the level of rural credit and to promote the cooperative societies and cooperative movement in the country, the Government established the Federal Bank for Cooperatives (FBC) and Provincial Cooperative Banks (PCBs) in the late 1970s. This was undertaken through an Ordinance in 1976 entitled the “Establishment of Federal Bank for Co-operatives and Regulation of Co-operative Banking Ordinance” was promulgated. The Federal Bank for Cooperatives (FBC) was designed as an apex body to meet the credit needs of cooperative banks and societies. It was designed as a development bank and served as a tool for the State Bank of Pakistan to regulate the Provincial Cooperative Banks. The SBP would lend to the Federal Co-operative Bank at just 0.5 percent. The Federal Bank would keep a percentage-based fee and pass on the subsidized funds to Provincial Co-operative Banks. These would then on-lend to the Co-operative Societies established in the provinces and registered and regulated under the aegis of the Provincial Co-operative Societies Department at a considerable profit (8 percent - 10 percent) (see Figure 2 below).

Figure : The Flow of Funds in the Cooperatives' Structure



17. Under the Cooperative system, an explicit relationship was established between credit and input use and credit and farm size[10].The FBC along with PCBs played a positive role in the development of cooperatives and extension of rural credit in the initial years. However, it

6. CRF. 2002
7. CRF. 2002.
8. CRF. 2002.
9. Rizvi: Shamim Ahmed, Restructuring of DBP. The Gulf Economist. Oct 21 - 27, 2002.
10. Iqbal, M., Ahmad, M. and Abbas, Kalbe. 2003.

could not sustain this effort despite the development of 66,000 primary societies, primarily due to misuse of subsidized funds by bogus committees and incapacity of FBC to effectively monitor and regulate the activities of PCBs and the Societies. The Cooperatives suffered from uneven coverage, with no presence in two thirds of the villages; lack of accountability and professional management; poor portfolio management; and weak supervisory capacity of the provincial cooperative departments. Cooperatives met with little success and have been mired in financial misappropriations due to politicization and domination by the rural elite. The Punjab Economic Research Institute (PERI) conducted an evaluation of the Cooperative Credit Programme in Punjab in August 1986. One of its main findings was that only four percent of the co-operative societies were genuine. Thus the subsidized credit was not being channeled to the intended beneficiaries. Clearly government policy was not working. These Cooperative Banks were a drain on the national exchequer. An estimation of the Subsidy Dependence Index (SDI) which measures the percentage increase in the financial institution's average on-lending interest rate required to fully compensate for the elimination of subsidy, revealed that the Punjab Provincial Bank was heavily subsidy dependent. It would have to increase its on-lending interest rate to 25 percent instead of 14 percent to fully eliminate the subsidy in 1994-95. Provisioning for reserve requirements would have entailed an even higher increase in on lending rates[11].

18. The commercial banks were the other important formal source of agricultural credit in Pakistan. Prior to the Banking Reform of 1972, commercial banks were generally reluctant to lend to the agriculture sector. The financing was limited to agricultural **marketing with produce** as collateral for the loans[12]. Under the 1972 reforms commercial banks were required to broaden the scope of lending to finance modern farm inputs and investments.The banks were required to fulfill a target lending for agricultural sector and were subject to penalties if they did not meet the targets. The Agricultural Credit Advisory Committee (ACAC) of the State Bank of Pakistan prepared agricultural credit estimates. The annual credit plan along with sectoral and institutional credit ceilings were approved by the National Credit Consultative Council (NCCC). Unlike the other formal credit institutions, the commercial banks depended entirely on their deposits for financing agricultural credit.

19. An analysis of the figures regarding the outreach of the commercial banks also reflects poorly on their rural outreach. The natural result of subsidized lending was that Commercial Banks were precluded from developing rural/agricultural credit market as a financially viable activity when the interest rate subsidy provided by ADBP made it attractive for large influential farmers to borrow from ADBP. Although in volume terms agricultural credit by CBs rose from Rs. 4.5 billion in 1991-92 to Rs. 12.06 billion in 1999-2000, the number of clients has stagnated around the 250,000 mark for the entire period. The branch outreach also indicated poor penetration of rural areas. Commercial banks in Pakistan had a total of 7,704 branches on 31st December 2006. Of these 2,542 or 33 percent were classified as rural and the balance i.e. 5,162 or 67 percent as urban bank branches. The volume of advances in the urban sector came to Rs. 1,530 billion which meant an average advance per urban bank branch was Rs. 296 million. In the rural sector advances were Rs. 117 billion showing the advance per branch at Rs.46 million. Advances of rural branches were therefore only 7.1 percent of total advances[13]. The commercial banks have only been focusing on a very narrow base of farmers, presumably the more influential and better off among the farming community. A study by PERI[14] showed that 35 percent of the sample loans were proxy and fictitious loans and 65 percent were 'loans actually got'.Main beneficiaries of proxy loans were landlords

11. CRF. 2002.
12. Qureshi and Shah .1992.
13. Banking Statistics of Pakistan – 2006. State Bank of Pakistan and Akhtar. 2007.
14. Flow of Commercial Banks Agriculture Credit" in 1986 on behalf of the Pakistan Banking Council. PERI. 1986.

who got 77 percent of the loan amount. Out of loans actually got' (i.e. 65 percent), only 23 percent were genuine loans[15].

20. At the beginning of the 1990's, the financial structure of Pakistan continued to reflect the policy initiatives taken in the early 1970s, which drastically enlarged the role of government in the process of deposit mobilization and credit allocation. However, it was clear that the government share in the financial sector and its policy of directed lending was not working and it was time to focus on a new approach. Development of rural financial markets was further impeded by repressive financial sector policies. Interest rate ceilings were common on both loans and on deposits. This limited the ability of lenders to charge cost recovery rates on their loans and limited their ability to mobilize deposits by paying attractive interest rates. Excessive legal reserve requirements were effectively a tax on deposit-taking and further lowered the rates of interest that could be paid on deposits. Limits on bank branching and on the formation of new financial institutions restrained competition and efficiency improvements in the sector.

21. The directed agricultural credit programmes proved to be subsidy dependent and ineffective in helping to achieve important goals. Instead of building a sustainable financial infrastructure, many of the directed credit programmes undermined the development of a viable financial market. Cheap credit was ineffective in alleviating rural poverty, in stimulating agricultural investments and in spurring agricultural production. Support for these traditional directed agricultural credit efforts began to wane in the 1980s and by the end of the decade most donors and some governments sharply reduced their support for agricultural credit. In part, this decline in support was due to the unsatisfactory performance of these efforts. Critics increasingly argued that relatively few of the credit subsidies were captured by poor people and that subsidized and directed credit had a weak effect on farm production and investment. Serious and chronic loan recovery problems, dependency on outside funding, and overall costs eroded the support for these efforts. Poor performance and the lessening of donor and government support led to the collapse of many public agricultural development banks and rural (government directed) co-operatives in the 1980s.

E. A MARKET ORIENTED APPROACH

22. The flaws of directed credit in the 1990s led to the formation of a new paradigm, labeled as the financial market approach. This realization was not unique to Pakistan but was also evident in some other developing countries where the trend was most decidedly towards a more market oriented approach. The late 1990s and early 2000s marked two significant moves in the financial sector in Pakistan. The first was the dismantling of the public sector infrastructure and the second was the establishment of a supportive policy framework for the facilitation and entry of the private sector into un-banked areas. Despite the opening of the non-bank financial sector for private investment in the mid-1980s, public sector financial institutions held the bulk of assets, deposits, advances and investments of the entire financial sector at the end of the 1980s. In 1990, the Bank Nationalization Act was amended to pave the way for privatization of the NCBs. Three major banks i.e. UBL, HBL and ABL were privatized through an open and transparent process. In 1991, the Bank Nationalization Act was further amended to empower the federal government to permit the establishment of a bank in the private sector if it was satisfied that such a bank would be in the public interest. Subsequently, ten new commercial banks were given permission to start operations in the private sector, of which eight actually commenced operations. During 1993-95, six new commercial banks were established in addition to two provincial banks (Bank of Khyber and Bank of Punjab), which were declared as scheduled banks. Thus, by 2004, 80 percent of banking assets were under the control of the private

15. CRF. 2002.

sector — a feat unprecedented for developing countries. Also, the government off-loaded 23 percent shares of NBP through an initial public offering in the local stock exchanges. The 1997 reforms also resulted in abolition of the Pakistan Banking Council and the strengthening of the SBP.

23. In keeping with its policy of enhancing the role of the private sector and the non-governmental sector, in early 2000 the government adopted a microfinance policy framework through the Microfinance Ordinance 2001. This Ordinance has been important for encouraging the entry of private sector players into the microfinance sector in Pakistan. Under the new regulation, seed capital requirements have substantially been reduced, licensing procedures, supervisory regulations and disclosure standards have been simplified. The First **MicroFinanceBank** Limited (FMFBL), Tameer Microfinance Bank Limited and Pak-Oman have been established to operate at the national level, while Rozgar Microfinance Bank Limited (RMFBL) and Network Micro Finance Banks Limited (NMFBL) are serving at the district level. The growth of new microfinance banks is mainly being sponsored by private individuals with a commercial interest or a social welfare objective. Pak-Oman Microfinance Bank is the only bank so far with substantial foreign investment.

F. TRANSFORMING PUBLIC SECTOR INFRASTRUCTURE

24. The Agriculture Development Bank of Pakistan (ADBP) was converted into a public limited company and renamed the Zarai Taraqiati Bank Limited (ZTBL) in 2002. The ZTBL was allowed enhanced paid up capital and a clean balance sheet with a leaner structure. The restructuring included its process, system and product reengineering, with major emphasis being laid on reorientation of existing employees with specific focus on their capacity building and induction of a professional management team. ZTBL restructuring was undertaken as part of the reform agenda of the ADB-funded Rural Finance Sector Development Program (see Section III-C, Para 40 for more on this Program). At the same time the Government liquidated the Federal Bank for Cooperatives (FBC). The Punjab Provincial Cooperative Bank is now the only scheduled cooperative bank which still has operations on the ground. The other Provincial Cooperative Banks may also be liquidated as they currently only exist on paper. At this time a host of private sector institutions were also established to enhance the accountability and transparency of the private sector institutions.

G. ADOPTING A HYBRID APPROACH

25. The ambivalence of Government policy even as it opened up to private sector and transformed its own institutions is evident by its rush to create specialized modalities for delivery of credit to un-banked areas and to the un-served and under-served poor households. Clearly, the Government had identified certain gaps and weaknesses and was trying to address those and was not comfortable with leaving everything to the private sector. Thus at the same time as Government was rethinking its approach towards the financial sector and dismantling public sector participation in the delivery of formal credit, it established two special modalities to deliver microfinance services. The Khushhali Bank (KB) and the Pakistan Poverty Alleviation Fund (PPAF). What is significant about these initiatives was that they were both sponsored by the donors. KB was established under financing from the Asian Development Bank and the PPAF was established with financing from the World Bank.

26. The government promulgated the Khushhali Bank Ordinance, 2000, to establish a microfinance bank named Khushhali Bank (KB). Keeping the experience of DFIs in view, this bank was established under the joint ownership of 16 commercial banks (three public sector, eleven private sector and two foreign banks). Its

organization and operations were specifically designed to support a sustainable community-based service delivery system by utilizing the services of NGOs besides using its own branch network. After several years of operation, the Government is now in the process of privatizing Khushhali Bank as well. The main impetus for this change has also come from a revision of donor policy on this issue.

27. The Pakistan Poverty Alleviation Fund was established in 2001. It was modeled on the Palli Karma-Sahayak Foundation (PKSF) of Bangladesh, which functions as an apex financing institutions for MFIs. Like the PKSF, the PPAF was registered as a private, autonomous company with its own independent Board of Directors. The PPAF has been established with a clear commitment to alleviating poverty and focuses on improving the access of communities to financial services and enhancing investments in productive infrastructure projects. From the initiation of its activities in 2000 to the end of December 2007, PPAF had disbursed a cumulative total of US$ 457 million to 71 Partner Organizations. On a cumulative basis it has disbursed US$ 348 million for credit, US$ 75 million for community infrastructure schemes and US$ 34 million for capacity building . While many organizations have intermediated grants funds, no other organization has ever taken the financial responsibility to disburse loan funds to the fledgling NGO sector on this scale before.

28. Today rural finance policy is a hybrid of the directed lending and the market oriented approach. While some of the Commercial Banks are not mandated anymore to give to agriculture sectors they are encouraged to do so The specialized agencies like the ZTBL have been restructured but there is little indication of an improvement in its performance. The cooperative banking structure is in disarray and the Government has been unable to put an institutional infrastructure in place which will deal with the issues of providing efficient services to rural cooperatives. There are plans to transform the Punjab Provincial Cooperative Bank and the Northern Areas Cooperatives into Microfinance Banks. A Credit Union Plan was part of the ADB financed Rural Finance Sector Development Programme but nothing has come off it as yet. Under the new paradigm Government interventions primarily relate to creating conducive policies and promoting strategic initiatives with incentive programs that promote private sector role in provision of financial services.

III. Sources Of Rural Finance Policy

29. The principal source of rural finance policy in Pakistan is the State Bank of Pakistan (SBP). However, policy pronouncements also emerge from time to time as part of donor financed projects. This is especially true in case of programmes which provide budgetary support to the Government of Pakistan and append a policy agenda as a condition for release of funds. In such cases, the policy agenda is driven by the donor in discussions with the government. The Ministry of Finance has played a marginal role in formulation of policy. At the Federal level the Ministry of Food Agriculture and Livestock's (MINFAL) policy role is limited to providing policy inputs through special committees formed for the purpose. Provincial Government's have played virtually no role in framing rural finance policy in Pakistan. However, sometimes there are declarations made by political leaders at the provincial level that can have an impact on provision of financial services in rural areas but this role is limited.

A. STATE BANK OF PAKISTAN

30. The State Bank of Pakistan is the primary source of financial policy in the country, including rural finance. Figure 3 below gives a snapshot of the various departments that could potentially have influence on rural finance policy, and their actual role.

Figure 3: Sources of Rural Finance Policy within the State Bank of Pakistan

Department/Source	Role in Rural Finance Policy
Governor	Leadership Role
Development Finance Group (DFG),	Policy Discussion and Formulation on Agriculture Issues
Agriculture Credit Department (ACD) and Agriculture Credit Advisory Committee (ACAC)	
Micro Finance Department	No specific focus
Islamic Banking Department	Policy on Islamic Agriculture financing under preparation
Small and Medium Enterprise Department	No role
Development Finance Support Department (DFSD)	Policy Dissemination and Feedback

31. The views of the Governor exert the most important influence on policy making at the State Bank. At the moment there is some disagreement within the State Bank on the role of the institution. While some feel that the State Bank should stick to its role of regulation and supervision, others feel that the State Bank of Pakistan should play a more proactive role in enhancing the outreach of the financial sector and ensuring that services are delivered to un-banked areas. This attitude permeates through the types of policies and discussions that are currently emerging from the State Bank. A very popular modus operandi at the State Bank of Pakistan has been the establishing of various task forces and committee to focus on specific aspects of finance policy. This modus has been used in the past as well. In its annual meeting in July 2007, the Governor constituted a series of committees to lay down additional ground work critical for the transformation of Pakistan's rural areas (see Policy Annex 1 and Policy Annex 2). What has given further impetus to this type of thinking is the Financial Inclusion Programme (FIP) which has recently been initiated with financing from the Department for International Development (DFID-UK). However, a review of the State Bank's guidelines on different types of financing shows that it has been extremely responsive to engaging with a wide range of stakeholders in the formulation of policy. This was evident from some of the minutes of its meetings, its process of engagement with its stakeholders, its process of drafting new policy guidelines and through the types of initiatives which it has been formulating.

32. The State Bank of Pakistan (SBP) reorganized itself in September 2006. There is no department at the State Bank of Pakistan which is exclusively responsible for formulating rural finance policy. However, under its newly created Banking Cluster the two main groups responsible for policy that can potentially impact rural areas are the Banking Policy and Regulation Group and the Development Finance Group (DFG). The Banking Policy and Regulation Group has the principal responsibility for coordinating the task of policy making. The SBP has established an internal mechanism for deliberating on policy aspects through its Banking Policy Committee

which meets as and when required. The Executive Directors and the Directors of the Banking Cluster related to the policy issue being discussed participate in the meetings of the Banking Policy Committee. Comments of key stakeholders are also invited and once the policy draft is prepared, it is also shared with the Pakistan Bankers' Association as well as other stakeholders. All circulars regarding new policy are issued by the Banking Policy and Regulation Department.

33. The Development Finance Group has created several new departments namely the Agriculture Credit Department, the MicroFinance Department, the Housing and Infrastructure Department and the Islamic Banking Department. In addition, Small and Medium Enterprises has also recently been added under this cluster. When asked specifically about how these departments dealt with rural finance issues, apart from the Agriculture Credit Department which was presumed to be working mostly in rural areas, none of the others made a distinction between urban and rural in designing their products or formulating their strategy. The State Bank of Pakistan has also created a Development Finance Support Department (DFSD). However, the role of this Department is not the formulation of policy but to disseminate the existing policy and interact with key stakeholders. Within the Development Finance Group there is no institutional home for rural finance policy. There is an assumption in the SBP that the Agriculture Credit Department (ACD) and the Micro Finance Department deal with rural finance issues. This is despite the fact that the ACD does not deal with the non-farm rural sector and focuses only on the agriculture sector. The Microfinance Department is directed at both urban and rural areas.

34. The stated functions of the Agriculture Credit Department are (i) to review the challenges to agriculture finance and develop an adequate knowledge and information base for policy formulation, (ii) to formulate agriculture and rural finance policies in consultation with stakeholders and ensure adequate flow of institutional credit to these sectors (iii) to coordinate with Federal and Provincial Governments on agriculture finance policies and issues (iv) to introduce new products and schemes in consultation with stakeholders to catalyze growth and activity in the sector (v) to review and amend existing policies, instructions and Prudential Regulations, based on new developments and feedback from stakeholders and (vi) Coordination with the 16 Local Agriculture Credit Advisory Committees at the regional level (see para 35 below for more on these regional committees). The State Bank has established an Agriculture Credit Advisory Committee (ACAC) which is chaired by the Governor of the State Bank. The ACAC has been instrumental in shaping policy for the agriculture sector. This is a high powered committee which reviews progress in the agriculture sector and establishes targets for the future. While the targets are not mandatory they are meant as indicative targets to ensure that financial services are made available to the farming community in Pakistan (see Box 1 on next page for more on the ACAC). A review of the minutes of the ACAC shows that the main mechanism used by the ACAC to frame policy is by developing new financial products and issuing guidelines for encouraging the provision of financial services to rural areas. The ACD is responsible for assessing and determining the requirements for agricultural credit in the country as well as coordinating with the different federal and provincial departments of major agricultural credit disbursing agencies like ZTBL/ADBP, FBC, and commercial banks. Federal Bank of Cooperatives provides production loans while ZTBL/ADBP and commercial banks advance both production and development loans.

Box 1: Agriculture Credit Advisory Committee

History

The Agriculture Credit Advisory Committee (ACAC) was established in the 1972 to ensure financing to the agriculture sector in Pakistan. In its initial years, the ACAC established mandatory targets for banks for lending to the agriculture sector. Any bank which did not meet the requisite targets would have to deposit the undisbursed amount with the State Bank for a year and no interest would accrue on this amount. Over the years, these targets have become indicative and no penalty is imposed on any bank not meeting its target.

Composition

The Agriculture Credit Advisory Committee is chaired by the Governor of the State Bank of Pakistan and its members include the MINFAL, Ministry of Finance, Presidents and representatives of the big five commercial banks, at least 3 to 4 top performers members from domestic private banks on a rotational basis, representatives from Standard Chartered and Royal Bank of Scotland , ZTBL and PPCBL, officials of federal and provincial agriculture and agriculture extension and planning and development departments, chambers of agriculture, farmer's, associations and representatives of the private corporate sector as well as academicians.

The ACAC meets twice a year. One Annual Target setting meeting is held at the start of the Financial Year in July-August to set the targets for the forthcoming year for agricultural credit and a second mid-year progress review meeting which is held in January-February to review progress.

Functions

- The ACAC meets to establish targets of agricultural lending and discuss ways in which agricultural lending can be enhanced.
- The ACAC also takes measures which are likely to enhance agricultural credit such as establishing special task forces and committees and commissioning research and policy papers.
- The ACAC meets twice a year. One Annual Target setting meeting is held at the start of the Financial Year in July-August to set the targets for the forthcoming year for agricultural credit and a second mid-year progress review meeting which is held in January-February to review progress.

35. As part of the institutional arrangements to facilitate this process, and in order to redress the local problems of farmers at their doorsteps and to make decisions on the spot, SBP has established Credit Advisory Committees and Agricultural Sub-Committee at its 16 SBP (BSC) Offices through out the country. The SBP has directed all Chief Managers at 16 centers of SBP: BSC (Bank) to play a leading role within the banking industry in their areas of jurisdiction efficiently and diligently, through interaction with the representatives of Chambers and, regional heads of banks plus field visits and should play a proactive role as a source of guidance on relevant matters concerning SBP and public. The Sub-Committee (Agriculture) consists of the representatives from Chambers of Agriculture/Farmer Associations/Banks and State Bank of Pakistan. Banks have been directed to delegate appropriate powers to their regional and zonal managers to take timely and prompt decisions on the spot/locally.

B. FEDERAL GOVERNMENT

36. One of the most popular methods for Government to engage in policy making is through the establishment of task forces. These task forces are constituted from time to time by the Prime Minister or other senior Government representative in response to emerging issues or sometime they are established in response to funding conditions For example, in order to in order to establish a policy for SME growth and employment generation, the Government established a task force in January 2004 under the auspices of the Ministry of Industries and Production, representing federal and provincial line ministries and agencies, as well as the private sector. Based on the recommendations of this Committee SMEDA prepared a modern SME policy and a modern SME Law, which were presented to senior policymakers. In response to the current food crisis, the Prime Minister has established various task forces and sub-committees to assess how best to cope with the rising food inflation. One aspect being deliberated by the sub-committee on public policy for food security is the level and terms of agricultural credit to small farmers[16]. Policy documents emerging from these forums are submitted to Cabinet for approval. However, the Prime Minister has the prerogative to approve policies without Cabinet submission if they are unanimously supported by Government departments.

16. Planning and Development Division. Planning Commission. Government of Pakistan. No.1 (2) M (F&A) PC/2008. May 29, 2008.

37. The Finance Division deals with the subjects pertaining to finance of the Federal Government and financial matters affecting the country as a whole, preparation of annual budget statements and supplementary/excess budget statements for the consideration of the parliament accounts and audits of the Federal Government Organization etc. as assigned under the Rules of Business, 1973. Finance Division maintains financial discipline through financial advisors organization attached to each Ministry or Division. The organizational chart of the Finance Division shows that there is an entire section dealing with policy issues. However, interviews with the staff from the Ministry of Finance indicate that this division does not deal with issues regarding rural finance directly. The Ministry of Finance plays only a marginal role in the formulation of rural finance policy. Its main role has been in ensuring that policy conditions which are attached to the release of donor funds are implemented so that the Government does not suffer cash flow problems. Thus its role has been more of an administrative nature. However, the Ministry of Finance is also responsible for some specialized institutions like the Pakistan Poverty Alleviation Fund and, the Khushhali Bank as these have been created as a result of donor financed projects. The Ministry of Finance sits on the Board of some of these institutions.

38. Traditionally, finance for agricultural and rural development has been a part of the agricultural sector policy falling under the umbrella of the Ministry of Agriculture. However, the key role in this connection has been played by the State Bank of Pakistan which has a separate department to deal with this aspect. The Ministry of Agriculture's role is confined to making statements of intent but it has a limited role to play in the process. This is mainly because the Ministry of Agriculture does not have any control on the institutions that actually implement the policy on delivery of financial services. Banks that deliver agriculture credit are generally dealt with by the State Bank of Pakistan. However, in some cases, banks which are regulated by special legislation, different from the banking law, are controlled and overseen by government officials under the direction of the Minister of Agriculture. From time to time, the Ministry may have access to project financing for the agriculture sector and it may then direct the design of the component. In the recently formulated national Agriculture Sector Strategy[17] there is a section on rural finance issue and constraints. While the strategy document outlines some key constraints in the sector it offers a very weak policy and action prescription none of which interestingly fall within the domain of MINFAL[18].

C. ROLE OF DONORS IN POLICY MAKING

39. A very important source of policy for the rural finance sector has been donor financed projects. The most significant influence has been exercised by the Asian Development Bank through its Microfinance Sector Development Programme (MSDP) and the Rural Finance Sector Development Program (RFSDP). The policy agenda appended to these projects identified the need for a policy and legal framework for the microfinance and rural finance sectors. Initiated in 2001, the Microfinance Sector Development Program (MSDP) defined a policy, legal, and institutional framework in order to facilitate microfinance service delivery. This project had three main objectives: a) to support the development of a conducive regulatory framework, which resulted in the promulgation of the Microfinance Institutions Ordinance 2001 enabling the establishment of sustainable microfinance banks; b) to facilitate the development of a microfinance bank as a public-private partnership, the Khushhali Bank; and c) to initiate the restructuring of Development Finance Institutions, mainly the Agricultural Development Bank of Pakistan, which is now called the Zarai Taraqiati Bank Ltd. In addition a series of funds, managed by the State Bank of Pakistan, were set up to support the

17. The strategy is still under formulation and is not available to the public to date
18. National Agriculture Sector Strategy. MINFAL. Government of Pakistan. August 2008. Preliminary Draft.

development of microfinance outreach in Pakistan, such as the Microfinance Social Development Fund, the Community Investment Fund, the Risk Mitigation Fund and the Deposit Protection fund.

40. The Rural Finance Sector Development Program (RFSDP), started in 2003, has been designed to assist the Government of Pakistan in accelerating rural economic growth by addressing key constraints in rural finance. The RFSDP comprised (i) a policy loan of $225 million equivalent to support policy and institutional reforms in the RF sector; and (ii) a project loan of $25 million equivalent for institutional strengthening. The program has four components: a) to create a favourable policy environment to the development of a market-oriented, mostly private-owned financial sector. b) to continue institutional restructuring and reforms, especially the key rural finance institution, ZBTL. c) to start a new bank fund, managed by the State Bank of Pakistan, which will be used as capital for lending to district level microfinance banks, and d) to encourage product and process innovations. A pilot insurance scheme was to be proposed to rural borrowers, to cover crop insurance related to natural disasters (floods, droughts). Three types of insurances schemes were to be considered as part of this project; agricultural insurance (including all production and marketing activities), crop insurance and a crop loan insurance. The crop loan insurance scheme has been recently approved by the SBP (see Section IV-L below).

41. Another key donor project which has helped to shape policy for the rural finance sector is the World Bank. Its financing of the Pakistan Poverty Alleviation Fund Project has made funds available for NGOs dealing with microfinance. While the World Bank did not have a policy agenda as it provided a project loan, it nevertheless helped to shape rural finance policy by demonstrating the scope and potential for growth of the NGO sector. The International Fund for Agriculture Development has helped to shape policy of individual institutions like the Agriculture Development Bank of Pakistan, the Bank of Khyber as it developed project loans which were to be disbursed through these organizations and they helped to alter the manner in which these organizations operated. The Department for International Development (UK) has initiated a new programme for Financial Inclusion with the State Bank. This is expected to focus on issues of rural finance.

42. Other donor financed projects which have helped to shape policy for rural areas is the Small and Medium Enterprise Sector Development Programme of the ADB. This US$ 152 million programme was designed to help Government develop SME Policy. As part of this programme the Government was to submit a detailed process and time-bound action and resource plan for consultative preparation and implementation of an SME policy. However, it was the SBP which was to review performance of financial institutions in SME finance and revise prudential regulations to encourage SME finance. The Government has waived or simplified taxation requirements and, in collaboration with the Federal Board of Revenue, is undertaking a study to further rationalize fiscal laws. Important measures announced in the SME policy include a 5-year tax holiday on sales tax for small businesses and a 50 percent reduction of the sales tax for medium-sized businesses. Five-year income and withholding tax holidays are additionally granted to SMEs targeting high-tech investment and exports. The SME policy was approved by the Prime Minister in May 2006.

D. ROLE OF KEY STAKEHOLDERS

43. In addition to the donors and Government, an increasing role is being played by the civil society sector in influencing policy. Organizations like the Pakistan Microfinance Network, the **Aga Khan** Foundation and others have played an important role in Pakistan. The **Aga Khan** Foundation was a staunch advocate of a special law regulating microfinance as it wanted to establish the First MicroFinance Bank. The Pakistan Microfinance Network has also played a

key role in shaping rural finance policy. It has engaged closely with the State Bank of Pakistan and has helped to create awareness on issues like financial sustainability, regulation, credit rating and credit bureaus. It has brought to the attention of policy makers the grass root realities of microfinance and promoted greater coordination among stakeholders on microfinance issues. The PMN have also interacted with SBP on the policy on mobile banking and branchless banking. The SBP has been very responsive to policy needs as they emerge and many policy issues that have been issued are a direct result of an open and responsive stance of the State Bank of Pakistan.

IV. Current Scope Of Rural Finance Policy

A. OVERVIEW

44. Despite this lack of an institutional home for rural finance, policy pronouncements which have a direct bearing on rural finance have been emerging from the State Bank of Pakistan with considerable regularity. While the SBP is following a policy that favors a market oriented approach, the thinking at the SBP reflects their view that growth and development of finance alone do not address questions of access. As a result the SBP is pursuing a policy of direct intervention to build a financially inclusive system. The SBP recognizes financial market failures and imperfections such as information asymmetries, lack of sensitivity to gender and redistributive dimensions of resources and wealth and high transaction costs. It also accepts that rural clients are faced with high price and non-price barriers such as lack of credit history and collateral and connection, etc[19]. As a result, the Bank does not follow the old policy of mandated targets but has now modified that policy and issues indicative targets to commercial banks. In addition, the SBP has announced regulation for agricultural financing which encourages commercial banks to develop an agricultural policy, develop innovative agricultural credit products and mechanisms for disbursing agriculture credit.

Box 2: Salient Features of Rural Finance Policy at the State Bank of Pakistan

- No institutional home exclusively for rural finance policy in Pakistan
- Most of the departments of the Development Finance Wing do not make a distinction between urban and rural in designing policy.
- Focus of policy almost entirely on provision of credit to the exclusion of other services.
- Assumption that microfinance reaches primarily rural areas
- SBP has proved highly responsive to incorporating stakeholder views in policy making.
- Assumption that agriculture credit meets all the demands of rural areas and there is some confusion regarding what the non-farm sector encompasses.

45. The one aspect of rural finance policy which has received the most attention is agriculture finance.The definition of agriculture finance by the SBP especially excludes non-farm activities even those connected to farm produce. The Prudential Regulations state that "agriculture financing shall not include loans to traders and intermediaries engaged in trading or processing of agriculture commodities. Such lending would fall under Corporate/Commercial Banking or SME financing. However, agricultural financing can be extended to entities (including corporate firms, partnerships, and individuals) engaged in farming activity as well as processing, packaging and marketing of mainly 75 percent of their own agriculture produce." To encourage agriculture finance, the main instrument of policy used by the bank is to issue guidelines on different types of agriculture finance which includes credit for poultry, horticulture, livestock, fisheries, etc. The ACAC forum is the principal mechanism for focusing on the issue of agriculture finance. However, within that forum there is some confusion as to the definition of non-farm sector. Within the ACD nomenclature "non-farm" is generally used to refer to livestock, dairy and fisheries sector financing.

While the SBP is following a policy that favors a market oriented approach, the thinking at the SBP reflects their view that growth and development of finance alone do not address questions of access. As a result the SBP is pursuing a policy of direct intervention to build a financially inclusive system.

46. Agriculture finance policy has evolved very rapidly at the State Bank of Pakistan and continues to show rapid progress under the current leadership. The rapidly evolving nature is also illustrated by the minutes of the ACAC.

19. Speech of the SBP Governor. March 2008.

During the time when mandatory targets were being enforced for agriculture sector lending and mandatory targets were allocated to the five big commercial banks and selected public sector banks, the scheme of agriculture lending was described as the Supervised Agricultural Credit Scheme. From time to time amendments were made in this scheme to facilitate lending to the agriculture sector. In 2001, as part of its efforts to to enhance the scope and eligibility criteria under the Supervised Agricultural Credit Scheme, a "Revolving Credit Scheme" was introduced on the recommendation of all participating banks as well as Chambers of Agriculture and Farmers/Growers Associations. The spirit behind the introduction of the said scheme was to facilitate the farming community for timely availability of credit without repeated documentations, bank visits and approvals the limits against full repayments. From time to time changes have been made to improve the flow of financing. In 2003 for example, in order to implement the Revolving Credit Scheme smoothly and uniformly, it was decided by the Agricultural Credit Advisory Committee (ACAC) to develop uniform and standardized definition and procedure, for banks under Agricultural Loans Scheme in consultation / consensus with all the participating banks. Accordingly the scheme was developed as a three years revolving credit with automatic renewal, one time documentation, partial repayments and annual cleaning of account (Principal and Markup) at any date convenient to the borrower. In addition to five big Commercial Banks, ZTBL and Provincial Cooperative Banks, 14 Domestic Private Banks were also inducted in the Scheme in 2001-02 and are being encouraged to get involved in extending credit to agriculture sector. In 2005, SBP consolidated some of its existing guidelines by issuing a separate set of Prudential Regulations for Agricultural Credit (see Section C on the right).

Figure 4: Time Line of Different Policy Instruments[20]

2008	September	Crop Loan Insurance Scheme Launched
	March	Branchless Banking Regulations For Financial Institutions
	March	Guidelines on Poultry Financing
	January	Financing Scheme for Small Farmers
2007	December	Guidelines on Horticulture Financing
	October	Branch Licensing Policy
	March	Revised Prudential Regulations For Microfinance Banks
	March	Guidelines for Fisheries Financing
2006	August	Guidelines for Livestock Financing
2002	March	Distribution of Mandatory Credit Targets into Production and Development Loans.
2001	April	Revolving Credit Scheme for Agriculture
		Supervised Agricultural Credit Scheme without territorial restrictions
1986		Supervised Agricultural Credit Scheme with geographic allocations for each major player
1973		Methodology Developed for Preparation of Agriculture Credit Requirements
1972		Agriculture Credit Advisory Committee Established
1972		Agricultural Loan Scheme Launched
1956		Creation of Agriculture Credit Department

47. On the assumption that microfinance has the potential to address the needs of the un-banked areas this sector has also received considerable attention by the SBP in the last few years. The promulgation of the microfinance regulation in 2001 signaled the start of a new era in banking in Pakistan. The regulation in Pakistan is poised to support three potential sources of growth in the sector. These include (i) transformation of NGOs into banks (ii) the establishment of microfinance banks and (iii) encouraging downscaling of commercial bank operations and offering microfinance services. In Pakistan, the regulation of the sector is a relatively recent phenomenon and only applies to microfinance institutions registered as banks. The introduction of a regulatory framework for microfinance banks in Pakistan is perceived as a positive development and most stakeholders interviewed felt that the Microfinance Ordinance provided a supportive environment for the sector. The Microfinance Ordinance and the Prudential Regulations in Pakistan appear to be consistent

20. For details of these different policy instruments, please see Policy Annex 3

with international practice on most aspects and seem to have embodied lessons from best practice elsewhere.

48. More recently the State Bank has started addressing the needs of the non-banked areas through a series of policy pronouncements regarding branchless banking, mobile banking, etc. The bank has been very proactive in this regard given that the services of the banking sector are highly concentrated in a few urban areas. However, the efforts of the SBP since the 1990s to grant licenses for new private banks on a geographically dispersed basis have not succeeded. The new private CB's have turned out to have an even greater urban industrial bias as over 80 percent of their business is concentrated in just 3 or 4 cities. One of the most important policy pronouncements with regard to rural areas is included in the new branch licensing policy which states that "at least 20 percent of additional branches planned to be opened by a bank under its Annual Branch Expansion Plans should be in Rural-Underserved Areas (RUAs)." It defines RUAs as villages, small towns and also includes Tehsil Headquarters where no branch of any bank already exists. The SBP will also allow banks interested in opening branches in RUAs to approach it any time for permission for the purpose. This is an exception which is allowed for rural areas as banks are not normally allowed to seek such permission once they have submitted their Annual Branch Expansion Plans.

B. AGRICULTURAL CREDIT REQUIREMENTS

49. One of the most avidly followed aspects of rural finance policy at the State Bank of Pakistan is the determination of the annual agriculture credit requirements which are set as targets by the ACAC. This indicative target setting has now replaced the mandatory target set of the Supervised Scheme which was in force earlier. These requirements are determined on the basis of a methodology which is modified from time to time. The first report on the methodology for the preparation of the estimates of agricultural credit requirements was devised in 1974. It was subsequently revised in 1979, 1983, 1989 and 2001. The most recent change in methodology was made in 2006 in view of the economic changes particularly in the agriculture sector[21].

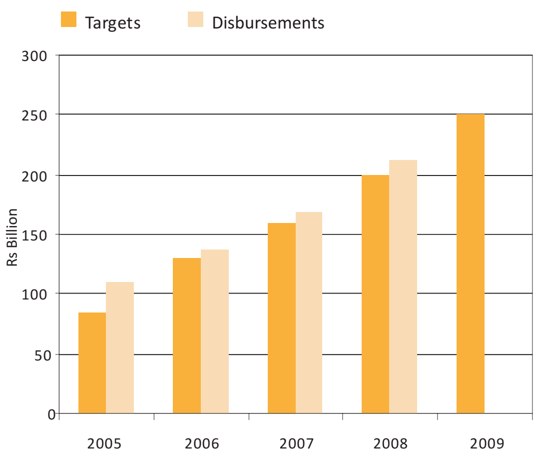
50. The methodology report gives a standard uniform criteria to prepare the agriculture credit estimates both country-wide and province or region wise. The report tries to estimate the need for credit for different agricultural inputs for different sizes of farms for the short, medium and long-term. The needs of crop, vegetable and livestock farming are included in the estimates. The document is also aimed at facilitating banks in estimating agricultural credit demands in their respective target markets. Further, it provides a list of items eligible for agriculture credit to assess the level and volume of credit required. Lastly, the per acre credit limits for banks recently notified by SBP, has been made part of the report to provide all information and criteria for credit need assessment in one document. This report is then used to give indicative targets on an annual basis to commercial and specialized banks for lending to the agriculture sector. There is no penalty if targets are not met but commercial banks are encouraged to meet these targets. Monitoring of the targets is undertaken in regular performance meetings at the highest level.

51. The targets set for agricultural lending by the ACAC have shown an average increase of around 25 percent% in the last four years. The targets are set for each of the participating bank in the ACAC. (Figure 5 on the next page) gives the targets for the last four years and reports on the actual disbursements. The established targets have always been met. For FY2007/2008, the Committee recommended the target of Rs 200 billion for credit disbursement to farmers. This assumed combined lending of Rs 132 billion from commercial banks and Rs 68 billion for specialized institutions i.e. ZTBL & PPCBL. The Committee also recommended province-wise allocations of disbursements, based on the cropped area and absorption capacity of each province, Azad Jammu & Kashmir and Federally

21. The latest methodology report can be accessed at http://www.sbp.org.pk/acd/2006/Methodology-Report-2006.pdf

Administered Tribal Areas. For the next year this target has been set at Rs 250 billion[22].

Figure 5: Agriculture Credit Targets and Disbursements



C. PRUDENTIAL REGULATIONS FOR AGRICULTURE FINANCING

52. Prudential Regulations for Agriculture Financing were developed after thorough consultations with major stakeholders, particularly banks in October 2005. These regulations are intended to provide a broader regulatory framework to the banks/DFIs. These are to be considered only as minimum standards and the banks/DFIs are advised to take sufficient measures to ensure that agricultural financing is undertaken in a prudent manner. Banks/DFIs are enjoined to prepare a comprehensive agriculture financing policy duly approved by their Board of Directors. The agricultural policy may be part of the overall credit policy of a bank/DFI. The policy should, inter-alia cover loan administration disbursement and appropriate monitoring mechanism. it shall also explicitly specify the main functions, major responsibilities and various staff positions' and the power and authority relating to approval and sanction of financing limits. Some of the former schemes like the revolving credit scheme (2003) also provide guidelines to Banks on how to structure the products and the process to follow in developing financial products for agri-lending (see Policy Annex 5).

53. The banks/DFIs are advised to put in place an appropriate management information system to monitor the quality of the agricultural portfolio and are encouraged to diversify their agricultural portfolio in terms of geographical areas, types of financing, to avoid the risks of concentration of credit. They are also encouraged to extend agricultural financing on the basis of future cash flows, instead of relying solely on collateral. The regulation states that standard cash flows can be estimated for different crops and these cash flows can then be adjusted for specific borrowers, keeping in view the quality of land and efficiency of the individual farmers, etc. While the margin requirements have generally been withdrawn by the State Bank and these are also not being prescribed under the new Prudential Regulations, the banks/DFIs may determine suitable margin requirements in their agriculture financing policies, keeping in view the quality and other characteristics of the collateral.

54. The regulation distinguishes between farm credit for inputs and farm development finance. The finance provided by banks/DFIs to purchase inputs like seeds, fertilizers, pesticides, etc. as well as working capital finance provided to meet various sort of expenses attributable to farming like wages, etc. will be categorized as farm credit for inputs. Such loans are self liquidating[23], with repayment occurring shortly after harvest from sale of the crop for which the loan was made. Farm Developmental Finance is a finance extended by the banks for making different types of improvements in the land including construction of godowns, etc. at the farm and for development of orchids, nurseries, etc. Such loans will be of long-term nature, to be allowed for a period of 5 years and above, with a loan-to-value ratio not exceeding 90:10. A third category is loans extended by banks/DFIs for the purchase of machinery and equipment used for agricultural purposes like tractors, threshers, tube wells, etc. The tenure of such financing

22. A brief graphical analysis of agricultural credit disbursement (farm and non-farm) during July 2007 – June 2008 is provided in Policy Annex 4.
23. The borrower repays the loan as inventory is converted into cash or a farm crop is sold.

should not be more than should not be more than the useful life of the machinery/equipment. The loans extended for goat/sheep farming, breeding of animals, dairy farming, fishing farms, poultry farms, etc. by banks/DFIs would fall under this category. The maximum tenure for livestock financing is indicated as five years[24].

D. FINANCING SCHEME FOR SMALL FARMERS

55. SBP in consultation with stakeholder has developed a group based financing scheme for small farmers. The scheme will target farming community involved in small agri-related activities like livestock, dairy, poultry, fisheries, horticulture etc. and do not have any tangible security to offer to banks as collateral. The scheme has been structured on group based lending approach wherein banks can finance to individuals through Small Farmer Groups (SFG). Small Farmer Group (SFG) will be formed by the banks. However, banks can also involve/outsource intermediary task to NGOs, outlets of farm input services providers etc. For outsourcing, banks should consider professional expertise and related experience in social mobilization and group formation. The role of each party is identified. Maximum financing would not exceed Rs.200,000 per borrower to meet their financial requirement which is within the clean lending limits of PRs for agriculture financing. The exact amount of loan will be determined by the bank based on genuine requirements and cash flow of the applicant. Maximum period of loan should be fixed as per PRs, repayment schedule may be set as per production cycle of the crop/non-crop activities being financed or revolving credit facility for three years subject to mandatory clean up of entire liabilities (both principal and mark up) once in a year or cash flow of the borrower in case of non-crop activities. The regulation states that it is advisable that the bank should have detailed understanding and information about the borrower's business and his assets as well as his capacity to effectively use and repay the loan. When asked if any bank was implementing this scheme, the ACD named Bank of Khyber.

56. Both working capital and term financing are envisaged. As stipulated in Prudential Regulations for Agriculture Financing, banks are asked to ensure disbursement of working capital/short term financing within seven days and for term loans within 15 days from the date of completion of formalities. Banks are advised to arrange insurance of the amount of loan disbursed for crop and non crop activities and life insurance of the borrower to safeguard the interest of the borrower and the bank, in case of losses due to natural calamity or events beyond the control of the borrower. It is the joint responsibility of the group members to ensure timely repayment of principal and mark up of the members[25].

E. GUIDELINES FOR LIVESTOCK FINANCING

57. In view of the significance of the sector in terms of contribution to GDP and employment and importance to serve as a vehicle to alleviate poverty rampant amongst the rural population where livestock is bred and maintained, the State Bank of Pakistan had established a Committee of Experts in August 2005 to come up with some strategy/program for increasing share of institutional finance for livestock. On the basis of its recommendations, SBP, framed guidelines to facilitate and encourage banks/FIs to build up their portfolio in the livestock sector. The guidelines cover all areas of the livestock financing business including product development and review, eligibility of borrowers, delivery channels, monitoring mechanisms, etc. The guidelines are suggestive and not mandatory in nature. Banks are asked to adopt the guidelines in their present form or with adjustments suitable for their respective organization needs and market characteristics.

24. For full text of the regulations, please visit http://www.sbp.org.pk/acd/PRs-Agriculture.pdf
25. For details of this scheme please visit http://www.sbp.org.pk/acd/FinancingSchemeSmallFarmers.pdf

58. The guidelines suggest that the Banks may consider establishing Livestock Research and Development Units at their Head offices to develop livestock financing products and their rollout in the field offices. The Unit could be a part of Agri/Rural Finance Division of the banks and be responsible for; a) target market analysis, its characteristics, size, trends, growth potential etc., b) development of products for livestock financing; c) developing procedures for product marketing, delivery mechanism, monitoring mechanism, follow-up and recovery; d) monitoring growth trends and quality of the portfolio and to develop close liaison with the field force to have feed back from the grass roots level, and; e) review developments taking place in the livestock sector within the country as well as in other parts of the world.

59. The guidelines on Livestock financing also include guidelines for dairy and meat farm financing. In its preamble, the guidelines point out that the easy and sustained access of dairy and meat farms to affordable financial services would enable the dairy and meat growers to acquire modern, efficient livestock facilities, infrastructure and processing systems for milk and meat production thereby giving boost to livestock sector to produce large quantity of livestock products for domestic consumption as well as for export. The guidelines discuss three types of financing for the dairy and meat farms namely working capital, term finance and composite loans. The limit amount may be assessed by the ACO/Branch Manager on the basis of financing request appraisal or feasibility report. Banks are free to determine mark up rate based on their cost structure and risk profile of the borrower and livestock sector. There will be no penalty on early repayments. At least bi-annual inspection by bank's trained officer or an independent veterinary doctor from an institution recognized by the Higher Education Commission. Necessary action should immediately be taken in the light of the inspection report. The guidelines also recommend a series of health precautions such as vaccination against contagious diseases, proper diagnosis and care of sick animals and encouraging artificial insemination of cows and buffalos from reliable sources.

60. The guidelines mention that the traditional commercial banking approach of waiting for the clients to visit branches to avail financial services normally does not work for agricultural loans. The banks will therefore have to devise innovative and cost effective mechanism to reach the clients market and sell their products. The branch and area managers should develop a comprehensive data base on the area/region the branch is supposed to serve consisting of the numbers of districts towns, union councils, villages in the area and their demographic data; the total cultivatable area, major crops, fruits, vegetables, the livestock statistics, no. of dairy farms, meat farms, cattle breeding farms; average number of cattle in each households; the level of presence of other Financial Institutions (FIs) etc. The ACOs/MCOs should be assigned the union councils and villages to be covered during a specified period along with the portfolio build-up targets. The Regional Managers/ACOs should arrange meetings with the villagers/farmers, livestock growers to introduce the products and services they are offering for the farm, non-farm and livestock sectors. The meetings should be arranged in consultation and collaboration with the active and influential persons of the village/area like Mosque Imams and Chaudrays etc. so that maximum number of villagers could be informed about the products. The meeting should be focused, standardized and time bound. After the introductory meeting the ACO should follow-up with the interested farmers/dairy growers for extending farm and non-farm products. The branches in rural areas or in small towns adjacent to rural areas should be designated as Agricultural and Rural Finance Branches and given specific business targets for agricultural credit and encouraged to become more and more mobile to market the bank's agricultural products.

61. Indirect lending may be made through milk processing units, sweet shops, biscuit manufacturers, ice cream parlours etc. The

banks may either provide loans to the milk processors for onward lending to livestock growers on guarantee of the processing units etc. or directly to the growers against the Deferred Bills issued by the processing unit. The wholesale funds to the processing units will however, be properly secured against charge on the assets of the processing unit, mortgage of rural/urban properties etc. For financing against Deferred Bills or discounting of Deferred Bills, the issuer of Deferred Bills should have relationship with the bank with automatic liquidation mechanism. The guidelines state that weak and traditional monitoring system of agricultural loans has also been one of the important reasons for low growth in agricultural and rural finance sector. The exceptionally good recovery rate of reputed Microfinance Providers (MFPs) across the world is attributable among others to effective loan monitoring systems developed and adopted by these MFPs[26].

F. POULTRY FINANCING

62. A special set of guidelines were introduced by the State Bank recently in view of the vast potential to invest in poultry industry. While issuing the guidelines, the SBP noted that the disbursement of credit to this sector during 2006-07 was only Rs.12.9 billion or 7.6 percent of total agriculture loan disbursed during the year. The SBP analyzed that one of the main reasons for the low disbursements to the poultry sector. These guidelines were developed by the SBP in consultation with banks, MINFAL, Pakistan Poultry Associations and other stakeholders. Banks can benefit from the guidelines to tap the sector that promises high returns to poultry farmers, banks and the economy as a whole. Banks may adopt the guidelines in the present form or with some adjustment to suit their organizational and operational needs and market characteristics, subject to compliance with SBP Prudential and other Regulations for agricultural financing. Both working capital and term financing are discussed. The limit amount may be assessed by bank on the basis of financing request, appraisal or feasibility report. Banks should undertake due diligence and market survey to assess the prices of equipment, vehicles and all those goods which a bank can finance for poultry farmers. Detailed parameters recommended for poultry financing are given. Banks shall determine mark up as per instructions contained in BPD circular No. 1 dated 21st January, 2004. Banks shall not charge any penalty on early repayment or adjustment of loans by the borrower. The hypothecated poultry stock and equipments should be comprehensively insured from reputed insurance company or group of companies. There should be a special condition in the insurance policy which should cover the risk of disease "avian influenza". It is advisable that banks should sensitize and educate their borrowers about the crucial importance of having an insurance cover and should make insurance an integral part of their respective poultry financing products. The guidelines also instruct the Banks to conduct properly inspections and ensure against poultry disease outbreaks[27].

G. HORTICULTURE FINANCING

63. The SBP also issued special guidelines for the horticulture sector. The SBP noted that the Banks credit to this sector is only 4-5 percent of the total credit to the agriculture sector. The disbursement to horticulture was only around Rs 6.5 billion in 2006-07 against total agri disbursement of Rs 169 billion during the period. One of the main reasons for low disbursement to horticulture sector is lack of awareness of banks regarding the sector. Therefore, in order to facilitate the banks, the guidelines for financing have been developed by SBP in collaboration with banks, MINFAL, PHDEB; hortibusiness finance sub-committee, farmer's representatives and other stakeholders. Banks can benefit from the guidelines to tap the sector that promises high returns to the horticulturist, banks and the economy as a whole. Guidelines similar to those in other areas of agriculture investment are given for this sector[28].

26. For full text of the Guidelines please visit http://www.sbp.org.pk/acd/2006/Draft-Gls-Livestock-Financing.pdf
27. For full text of the Guidelines please visit http://www.sbp.org.pk/departments/acd-poultry.htm
28. For full text of the Guidelines please visit http://www.sbp.org.pk/guidelines/Horticulture.htm

H. FISHERIES FINANCING

64. The SBP noted that like other sub-sectors, the fisheries sector also remained largely untapped and comparatively small and almost unchanged over the last ten years. Fisheries contribute only 0.3 percent to overall GDP and 1.3 percent to agricultural GDP. The preamble in the guidelines notes that the fisheries sector is not yielding returns commensurate with its potential. The Government is taking keen interest in the development of the fisheries sector and the guidelines cover both marine and inland fishing. In August 2005, the SBP established a Committee of Experts to come up with a strategy for increasing institutional finance to neglected sub-sectors of agriculture. As a result, the committee submitted its recommendations for financing fisheries. The guidelines for fish financing are aimed at assisting and facilitating banks to penetrate the fisheries sector by rigorously financing related activities. Banks are encouraged to obtain comprehensive insurance of the hypothecated/mortgaged assets e.g. motor boats/fishing trawlers/ cold storage, etc. as per policy of the bank[29].

I. SME & MICRO FINANCING

65. Since 2004, the SBP has undertaken major reforms to support **non-collateral based** lending for SMEs and individuals by issuing prudential regulations for SME finance and consumer finance. The share of bank loans to SMEs increased from 14 percent to 16 percent in 2006. With the rapid growth of new products in SME and consumer finance, it is critical that FIs establish appropriate underwriting and risk-management capabilities to ensure that asset quality does not deteriorate. During 2006, the SBP significantly improved asset classification and risk provisioning requirements, including financial services to SMEs. The extent to which MSE financing reaches rural Pakistan is however not clear.

66. The Microfinance Ordinance 2001 stipulates the functions, capital requirements, ownership structure, terms and conditions for establishing Microfinance Banks/Institutions in the country. It allows establishment of four categories of MFBs i.e. at the national level, MFBs operating in a Province, MFBs operating in a region of 4 districts and the MFBs operating in a specified District with minimum capital requirements of Rs.500 million, Rs.250 million, Rs.150 million and Rs.100 million respectively. The prospective MFBs are required to be incorporated as Limited Liability Company under the company law before applying to State Bank of Pakistan (SBP) for an MFB license. The SBP being the only regulatory and supervisory agency for all deposit taking institutions has been entrusted with responsibility for regulation and supervision of MFBs as well. It will use both off-site and on-site surveillance techniques for the purpose. The framework provides the scope for NGOs to become regulated MFBs provided they meet the requisite criteria. In addition, banks can also operate microfinance operations through various options given in the Guidelines.

J. BRANCHLESS BANKING

67. One of the regulations with the most far reaching impact especially on the provision of services in rural areas was the one regarding Branchless Banking (BB) by using delivery channels like retail agents, mobile phones, etc. The SBP feels that this represents a significantly cheaper alternative to conventional branch-based banking and allows financial institutions and other commercial players to offer financial services outside traditional banks' premises. The SBP believes that BB can be used to substantially increase the financial services outreach to the un-banked communities. In line with its responsibility to promote financial inclusion without risking the safety and soundness of the banking system, the State Bank issued a policy paper on regulatory framework for mobile banking in Pakistan which stipulated SBP's strategy for promoting branchless banking. SBP has now prepared guidelines as part of the broader strategy to create enabling regulatory environment to promote Bank-led Model of branchless banking and sought comments from all the stakeholders. The primary audiences of

29. For full text of the Guidelines please visit http://www.sbp.org.pk/acd/2007/Guidelines-for-Fisheries-Financing.pdf

these draft guidelines are financial institutions (Commercial Banks, Islamic Banks, Microfinance Banks and Development Finance Institutions) desirous to undertake branchless banking. Guidelines also contain sections defining the use of agents for conducting branchless banking activities (including cash deposit and withdrawal), use of third party service providers, data and network security, risk management program and customer protection and awareness.

68. New options include opening of sub-branches as a conduit of branches. Under sub branch option, banks can provide limited general banking functions to their customers and disbursement and recovery of agri and rural financing, group based lending, lodgement and settlement of insurance claims, etc. Under the sales and service centers option banks can provide product information and queries and customer support services. Banks have also been allowed to offer mobile banking facilities through their branches, with the objective of retail delivery of financial services at the doorsteps to the bank customers.

K. BRANCH LICENSING POLICY

69. The State Bank of Pakistan (SBP) has comprehensively revised its Branch Licensing Policy (BLP), introducing several new initiatives for introduction of cost effective option for the banks to expand the outreach of banking services in general with specific focus on rural and underserved areas of the country and also to improve agricultural finance. Furthermore, all banks are required to open 20 percent of their total branches approved under their respective annual branch expansion plan in rural and underserved areas.

L. CROP LOAN INSURANCE

70. A meeting of the State Bank of Pakistan's Task Force on Crop Loan Insurance Framework agreed to launch a crop loan insurance scheme for farmers throughout the country from the coming Rabi crop season. The Task Force was constituted under the Chairmanship of President Habib Bank Ltd and was assigned the task to develop a commercially develop a commercially viable and sustainable Crop Loan Insurance Scheme with the help of key stakeholders to mitigate the risk of losses occurring to agricultural borrowers due to natural calamities and risks of defaults to banks by such borrowers. The scheme would provide cover to the borrowers against their losses due to natural calamities up to the amount of the outstanding loan and mark up thereon. The insurance companies will charge a maximum of 2% premium for all major field crops and the risk is covered against excessive rains, hail, frost, flood, drought, and crop related diseases like viral and bacterial attacks or damage by locusts. The scheme will be mandatory for the borrowers of the banks. The representatives of the insurance companies agreed that after successful implementation, the insurance cover will also be extended to the non-borrowing farmers. The State Bank of Pakistan was planning to issue a working paper to the banks on the modalities of crop loan insurance. Simultaneously, the Ministry of Finance is working on the operational framework for payment of insurance premium by the government on behalf of small farmers. To facilitate the small farmers, the government has agreed to share the premium cost of subsistence farmers. The SBP wants the banks to adequately publicize the scheme for the benefit of the farmers. The SBP hopes that banks will also adjust their agriculture loan pricing following the introduction of Crop Loan Insurance Scheme as it will mitigate their risk of losses due to natural calamities.

V. The Impact Of Rural Finance Policy

71. It is clear from the foregoing analysis that the rural sector has generally been ignored by policy makers. At best the focus of policy has been on agriculture to the neglect of other non-farm enterprises. Even though the contribution of farm and non-farm sectors to GDP is about the same, the non-farm sector has received little or no attention.

The farm sector accounted for 84 percent of the agriculture credit and only 16 percent went to the non-farm sector in 2006[30](see Policy Annex 4 for a comparison of farm and non-farm credit). Furthermore, the focus of policy has been almost exclusively on the provision of credit. Banking services like deposit mobilization, insurance and transfer of fund services have generally been ignored, or touched in a very superficial manner. There is general consensus that the rural sector has suffered from policy neglect, poor design and weak implementation of delivery systems for each of the four financial services namely credit, savings, insurance and payment of funds. The services provided have been inadequate as well as inconvenient and inappropriate[31].

There has been an extremely unequal distribution of credit within the agricultural sector. The bigger farmers have hijacked a major share of loans from ADBP, Commercial Banks and Cooperative Banks. The benefit of subsidized credit from these institutions has gone mainly to the influential farmers.

72. Current Government policy seems to rely primarily on encouraging the commercial banks to lend to rural areas. The regulation with its guidelines and indicative targets seems to be based on the assumption that the banks are not aware of the opportunities for lending in these areas and issuing guidelines will somehow address the issue. What is ignored in this approach is that the current orientation, organizational culture and cost structure of commercial banks are all aimed at lending to urban and industrial areas. The newly licensed private banks have an even more pronounced industrial and urban bias than the commercial banks of the 1990s. It is estimated that 80 percent of their advances are concentrated in three or four cities. This urban based approach has also proved highly profitable for banks which have made enormous profits in the last few years. The high cost of lending to rural clients further inhibits loaning to rural activities. In fact, commercial banks are in the process of shutting down a significant number of rural branches.

73. The fact that the indicative agricultural lending targets have consistently been met in the last few years shows that the targets are set too low. The analysis shows that the provision of credit to agriculture has not adequately met the needs of the small farmers despite Government's focus on this area by creating specialized institutions, providing them lines of credit and encouraging the participation of the commercial sector in this area. In 2002, the ADBP, commercial banks and cooperative banks had together, in volume terms, met only 30 percent of the agriculture credit needs. The performance on the basis of percentage of farmers covered was even more dismal as the needs of only 15 percent of the farmers were being met[32]. There has been an extremely unequal distribution of credit within the agricultural sector. The bigger farmers have hijacked a major share of loans from ADBP, Commercial Banks and Cooperative Banks. The benefit of subsidized credit from these institutions has gone mainly to the influential farmers.

74. In the last few years there has been rapid growth in agriculture credit in Pakistan. In volume terms the total credit disbursements have grown from Rs. 109 billion in 2005 to Rs. 169 billion in FY 2006-07. Of this, Rs. 80 billion has been disbursed by the five big commercial banks[33], Rs. 56 billion by ZTBL, Rs. 8 billion by the Punjab Provincial Cooperative Bank Limited and Rs. 24 billion by other Domestic Private

30. National Agriculture Sector Strategy. MINFAL. 2008.
31. Committee on Rural Finance. 2002.
32. Committee on Rural Finance. 2002.
33. These are National Bank of Pakistan (NBP), Habib Bank Limited (HBL), United Bank Limited (UBL), MCB Bank and Allied Bank Limited (ABL).

Commercial Banks. Rs. 24 billion by other Domestic Private Commercial Banks. However, in contrast to the increasing agri-credit disbursements, the number of borrowers witnessed a decline. This means that the average size of agri-loans increased and suggests that small farmers did not avail the financing facilities at the same pace as in previous years. All the provinces except Punjab exhibited a low absorption of agricultural credit and could not meet the allocated percentage of indicative credit disbursement targets. The SBP reports that the satisfactory performance in Punjab was largely due to the efforts of the Government of Punjab which created the right environment and made proper institutional arrangements for promoting credit delivery (see Figure 6 below for graphical presentation of the agri-credit pie by province and by type of financial institution). What is not clear from the State Bank reports is the extent to which the rural needs are currently being met by the various delivery mechanisms. As such, it is not clear whether the gap in supply and demand is growing or narrowing despite the overall increase in the disbursement of agriculture credits.

Figure 6A: Bank-wise Disbursements of Agri Credit (2006-2007)

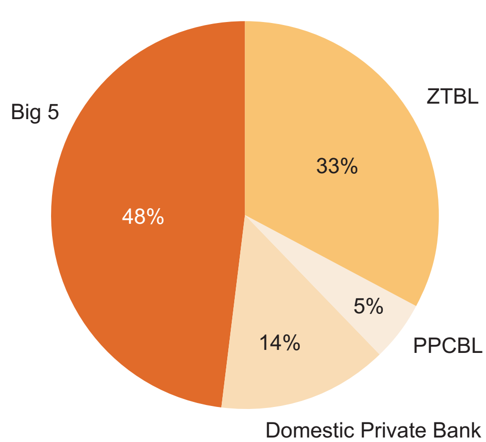
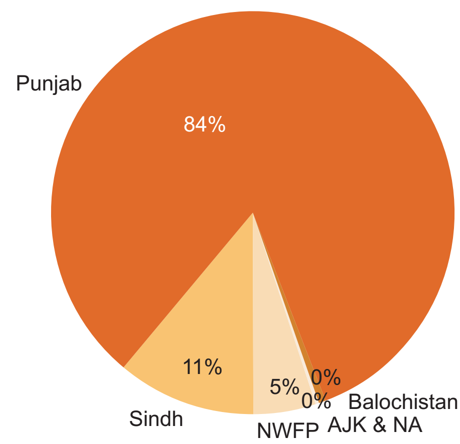


Figure 6B: Province-wise Disbursements of Agri Credit (2006-2007)



75. Another gap in the SBP's policy towards the rural sector is the fragmentation with regard to the formulation of policy and its supervision and enforcement functions. While the SBP has created a special functional division to formulate and review policy for agriculture, there is no such mechanism for the rural sector overall. Furthermore, even as far as agriculture loans are concerned, it is the On-Site Examination Department which is expected to monitor progress on the different aspects of SBP policy and the extent to which banks are adopting the suggested guidelines. The Enforcement Department which is yet another separate department is expected to ensure enforcement. While the ACD has some feedback mechanisms available for progress review from the banks in its quarterly meeting, it is generally not very well aware of how the different guidelines are being used especially since these are meant as suggestions and not regulations.

76. Another key gap in the SBP policy with reference to rural financial services is its preoccupation with credit to the exclusion of other services. One forgotten service is savings. There has been little incentive for government financed institutions to offer savings services. The ADBP and the Cooperative Credit

Institutions all depended on cheap lines of credit from the State Bank of Pakistan. As such, these organizations were not oriented towards deposit mobilization. The Khushhali Bank was designed to mobilize savings but had little incentive to do so as it was offered a line of credit from its donors and corporate partners. As a result it did not offer savings services to its clients although it kept claiming that this would soon be included in its package of services in the next phase. The lack of relevant saving products available to the rural sector has led the rural sector to concentrate its savings primarily in livestock. The Government has recently announced its intention to withdraw the subsidized lines of credit from these institutions. While this may encourage them to develop more effective deposit mobilization schemes, their performance in this regard is yet to be seen. The Committee on Rural Finance had little confidence in these organizations as it felt that the staff in most of the public sector institutions consists of agriculture scientists who are not trained in banking and have little incentive to aggressively pursue rural clients.

77. The policies implemented in many developing countries today reflect the shift from a traditional supply-led directed credit approach to more market-oriented, demand-led financial services. However, this by itself may not be sufficient to address the needs of the rural sector.

77. The policies implemented in many developing countries today reflect the shift from a traditional supply-led directed credit approach to more market-oriented, demand-led financial services. However, this by itself may not be sufficient to address the needs of the rural sector. The fact that there is no permanent institutional mechanism, which can analyze the situation in the area of rural finance and come out with policy proposals to rectify the policy mistakes also contributes to the problem.

The State Bank of Pakistan had constituted a Committee on Rural Finance in 2002. While the Committee submitted a report it is not clear what happened to this report. The challenge in rural finance is for policies that promote the development of a variety of viable financial institutions that are client oriented, mobilize deposits efficiently and provide access to loans for a broad spectrum of farmers, agribusiness entrepreneurs and other rural clients.

VI. Implications for the Microfinance sector

78. There are several implications of the current policy framework for rural finance for the microfinance practitioners in Pakistan. These can be classified broadly into three categories:

- I) Policy advocacy
- ii) Institutional growth and development
- iii) Operational implications in the implementation of services and financial products.

Each of these has been elaborated below.

A. POLICY ADVOCACY

79. The State Bank has been extremely responsive to change in the last few years and has played a leadership role in establishing legal frameworks and guidelines for promotion of microfinance and agriculture finance in the country. While the various departments of the SBP have been making policy pronouncements on aspects of financial policy which can help to enhance outreach, there is no one within the SBP who is really advocating the cause of rural finance. As such, many opportunities for creating synergies and capitalizing on existing initiatives are lost. Due to the lack of an orientation on rural finance, the impact of some of the measures on rural finance is not fully explored. The microfinance practitioners have been a strong advocate for policy change at the State Bank and have been much better placed than the commercial banks to influence policy. A primary reason for this is the forum afforded to them through the Pakistan Microfinance Network. There is a need for the PMN to engage with the State Bank and help clarify understanding and build awareness about the special needs for rural finance other than agriculture and microfinance.

80. There is need to establish an institutional home within the SBP for rural finance. The Committee on Rural Finance (CRF) had observed that the greatest missing link was the absence of an institution to create synergies between the different agencies responsible for rural finance. The PMN would be well served to highlight this issue. While the report of the CRF had emphatically recommended this move it is not clear why it was not implemented. The ADB financed RFSDP also enjoined that the existing MF Support Division of SBP will be enlarged to a Rural and MF Support Division. The creation of a new Rural Finance Department within the SBP department would help to build synergies between the various initiatives and departments of the SBP such as Islamic Banking Finance, SME financing, Housing and Infrastructure, etc. Such a Rural Finance Department would serve as a catalyst in focusing on different aspects of rural finance policy in close participation with the stakeholders with the blessings of the SBP. This forum could also be charged with the responsibility of reviewing the impact of the various SBP guidelines on delivery of credit to rural areas. This could have a strong research, training and supervisory capability and involve all stakeholders in rural finance and provide a platform for informed debate on rural finance issues. It is in the interest of the microfinance practitioners to recommend such **as move as** they look to expand their outreach to rural areas.

There is need to establish an institutional home within the SBP for rural finance. The Committee on Rural Finance (CRF) had observed that the greatest missing link was the absence of an institution to create synergies between the different agencies responsible for rural finance.

81. From a review of the current policy framework, it is evident that one of the main instruments of Government policy is to encourage commercial banks to enhance outreach to rural areas. There are many areas in which a partnership with the microfinance practitioners and commercial banks would serve the interests of both. While in the past some of these opportunities have been effectively pursued, there are many opportunities which exist but have not been fully explored. The State

Bank of Pakistan has established indicative targets for the agriculture sector and this policy has proved effective in establishing a minimum amount of credit which has been channeled to the agriculture sector. If a mechanism similar to the Agriculture Credit Advisory Committee was established for determining the requirement for the non-farm sector in rural areas it would help to focus on the needs of this sector. In addition, MFPs could be invited by the State Bank to this forum. The partnering of commercial banks with PMN members and other practitioners of microfinance is a key opportunity which has not been systematically explored under the aegis of the State Bank.

B. INSTITUTIONAL GROWTH AND DEVELOPMENT

82. The State Bank of Pakistan is keen to expand the outreach of financial services to un-banked areas. Building financial infrastructure appears to be a high priority of the Government for improving rural finance. The SBP has taken the leading role in developing regulatory systems and providing incentives for the development of the sector. A key aspect of this policy is to promote the entry of new players and to encourage leading NGOs to transform into banks. The State Bank of Pakistan is currently in a very facilitative mode with respect to the role of microfinance practitioners. As such this is a good time for them to capitalize upon this opportunity and apply for licensing and transformation if this fits in with their overall strategy and organizational growth trajectory. Some organizations like Kashf and NRSP are already capitalizing upon this opportunity and KASHF has received license for commencement of operations and NRSP has received an NOC to establish a MFB.

83. Equity participation is a key constraint for microfinance practitioners. This issue has not been fully discussed in Pakistan and there is no mention in the current rural finance policy framework emanating from the SBP of equity options and opportunities. If the problems of rural finance were highlighted, the need for equity participation in the sector would be one of the key constraints identified. However, the RFSDP of the ADB states in its project document that the SBP will not hold equity in RFIs to avoid conflict of interest. It was partly as a result of the policy pronouncements of this project that the SBP equity in ZTBL was converted to subordinated debt or tier 2 capital. It is in the interest of the microfinance practitioners to highlight this issue and bring it to the attention of policy makers. The CRF also suggested that equity participation should be available from the SBP in its effort is to attract a new breed of banking entrepreneurs willing to operate in rural areas. A specific policy recommendation in this regard by the CRF was that a facility of up to 49 percent equity participation with pre-determined buy out terms should be available for those who want it. While a detailed examination of whether SBP should take an equity position in RFIs or MFBs involved in rural finance is beyond the scope of this paper, this is an issue which could be further debated in a forum supported by the SBP and the microfinance sector.

C. OPERATIONAL IMPLICATIONS

84. The State Bank of Pakistan has recently announced a host of initiatives regarding branchless banking, mobile banking, appointment of agents, service centers, etc. The guidelines give some broad paths for institutional collaboration. The aim of public policy is to help promote institutional innovations that assist the disadvantaged or address intrinsic market failures. Recent experience with institutional innovations has shown that programs must be designed to harness a community's particular strengths in order to reduce costs of screening participants, monitoring financial activity, and enforcing contractual obligations. The group-based system

has worked well in Bangladesh, whereas several programs in Indonesia successfully use local agents to assess borrowers' creditworthiness. Many of these initiatives are likely to help reduce the transactions cost of delivering services to rural areas. There is an opportunity here for innovation, product development and collaboration between the commercial banks and microfinance practitioners. The implications of these policy guidelines need to be fully assessed in a joint forum in which the State Bank, MFIs and CBs sit together on a regular basis.

85. At one time the State Bank had taken a leadership role in developing and training NGOs in understanding the basic concepts of Islamic financing and developing Islamic banking products. However, these initiatives were not pursued with vigour by the SBP and seem to have fizzled out. It would be in the interest of the microfinance practitioners to re-engage the State Bank in their supportive role especially in view of the potential to expand this line of financial products to rural areas. From this would emerge a range of initiatives and products which could then be taken up by the PMN partners through their own resources. Similar opportunities may exist in the area of housing finance, SME finance etc and need to be pursued. The newly established Financial Inclusion Programme which DFID has initiated with the State Bank of Pakistan could be used to further foment the relationship between the microfinance practitioners and SBP.

86. There are additional implications for the microfinance practitioners in this move from directed credit to following a financial market system. This conversion to a market led system involves interest rate deregulation, a reduction of subsidies and fewer facilities in central banks providing concessionary funds to a reduction of subsidies and fewer facilities in central banks providing concessionary funds to lenders. All of this implies that financing for the rural sector is likely to become more expensive and that the volume of government funds invested in the sector is likely to reduce. This is already in evidence in the withdrawal of the lines of credit to the ZTBL and the Punjab Provincial Cooperative Bank. The PPAF which is the main provider of funds for the microfinance sector, especially NGOs, has also been under pressure to increase its interest rates and has been gradually increasing the price of its funds. Furthermore, the MFIs are increasingly looking to commercial sources of funds for their expansion. As Government policy has not made a sharp distinction between funds going to urban and rural areas, those operating in rural areas are not being granted any special favor. On the brighter side, since there are no subsidies associated with loans there are no favors associated with lending. The implication of this for all service providers, not just for MFPs, is that they must treat their borrowers and depositors as valued clients if they are to stay in business. This entails much greater attention to the quality of services, transaction costs and financial innovations that reduce costs.

87. There is no concept of subsidy in the existing policy. Some analysts are concerned of the implications of this for rural service provision and feel that without such a subsidy MFPs and other service providers will not be able to sustain their operations. They point to the fact that even successful credit institutions like the Grameen Bank, Bangladesh and the Bank for Agriculture and Agriculture Cooperatives, Thailand were not able to sustain their operations without subsidy and incentives in their lending rates. The CRF was concerned about this issue and recommended a subsidy of between 2 percent to 5 percent on the loans advanced by a rural bank depending on the local conditions the bank operates. The ADB RFSDP states clearly that the SBP will only be the lender of last resort to RFIs and not a refinancing agency using its own resources.

88. The current focus is on agriculture credit and microfinance. The needs of the non-farm sector have generally not been addressed and the SBP has developed its own definition of non-farm as has been highlighted earlier in this paper. Similarly the focus of services has been on credit and other services such as savings, insurance and transfer of funds have been generally neglected. The potential of Life Insurance in the rural sector has not been tapped although the newly announced policy on crop loan insurance is a good beginning. A breakthrough can only be made by the creation of innovative linkages between existing insurance companies and the purveyors of Rural Finance. There are synergies possible between the Post Office department and microfinance providers, between the existing insurance companies and the new proposed rural banks and between new rural banks and microfinance institutions. The SBP should serve as a bridge between international best practices in Rural Finance and local institutions. The PMN could help foster these links for its partners.

Annexure

ANNEX 1. REFERENCES

Akhtar, Dr. Shamshad. 'Building Inclusive Financial Structures'. Speech given at DFID and HM Treasury Financial Inclusion Conference, 19 June 2007.

Akhtar, Dr. Shamshad. Governor State Bank of Pakistan. Key Note Address - Expanding Access to Finance. USAID and Shore bank International. WHAM Project 2005-08. 28th March 2008 – Islamabad.

Asian Development Bank. Report and Recommendations of the President to the Board of Directors on the Proposed Loans to the Islamic Republic of Pakistan for the Rural Finance Sector Development Programme. November 2002.

Coffey, Elizabeth. Agriculture Finance Revisited: Agricultural Finance: Getting the Policies Right. FAO and GTZ. FAO 1998.

Haque, Nadeem ul. Beyond Planning and Mercantilism: An Evaluation of Pakistan's Growth Strategy. The Pakistan Development Review. 45: 1 Spring 2006. Pp. 3–48

Husain, Dr. Ishrat. Short History of the Banking System in Pakistan. Blue Chip. August 2008.

Imaduddin, Muhammad Assistant Director. Policy & Regulatory Framework for Microfinance Banks/ Institutions in Pakistan. For SAARC Finance Seminar: Micro-credit Operations Dhaka, Bangladesh. Banking Supervision Department. State Bank of Pakistan. December 2002

Iqbal, Muhammad, Ahmad, Munir and Abbas, Kalbe. The Impact of Institutional Credit on Agricultural Production in Pakistan. The Pakistan Development Review. Pakistan Institute of Development Economics. 2003.

Janjua, Ashraf et al. Report of the Rural Finance Committee. State Bank of Pakistan. 2002.

Meenai, S and Javed Ansari. Money and Banking in Pakistan. Fifth Edition. 2005.

Ministry of Agriculture. National Agriculture Strategy. Draft. Ministry of Agriculture and the Asian Development Bank. August 2008.

Pakistan Microfinance Network. MicroWatch. Issue 5, Quarter 3. July-September 2007.

PERI. Flow of Commercial Banks Agriculture Credit” in 1986 on behalf of the Pakistan Banking Council. Punjab Economic Research Institute. 1986.

Qamar, Naveed. Budget Speech of the Minister of Finance. Richard L. Meyer and Geetha Nagarajan. Rural Financial Markets in Asia: Policies Paradigms, and Performance. Study of Rural Asia: Volume 3. 2000.

Qureshi S. K and Akhtiar H. Shah. A Critical Review of Rural Credit Policy in Pakistan, The Pakistan Development Review 31:4. Pakistan Institute of Development Economics. 1992.

Sheikh, Ghulam Muhammad. An Empirical Study of Comparative Banking in Pakistan. University of Karachi/Department of Economics. August 2008.

State Bank of Pakistan. Annual Report 2007- 2008. Review of the Economy. Volume I. State Bank of Pakistan.

State Bank of Pakistan. Annual Report 2007- 2008. Performance Review. Volume II. State Bank of Pakistan.

ANNEX 2. LIST OF PEOPLE INTERVIEWED

Ashraf Khan, Director Agriculture Credit Department, State Bank of Pakistan

Dr. Saeed Ahmed, Head Financial Inclusion Project. & Director Microfinance Department, State Bank of Pakistan

Jameel Ahmed, Executive Director, Banking Policy & Regulation Group, State Bank of Pakistan

Khalid Nawaz, Financial Sector Strengthening Programme (FSSP)

Malik Hassan Iqbal, President, Punjab Provincial Cooperative Bank

Parvaiz Saeed, Director Islamic Banking, State Bank of Pakistan

Parvaiz Tariq Dar, General Manager, Punjab Provincial Cooperative Bank

Peter Knoll, Asian Development Bank

Qazi Muqtadar, National Institute of Banking & Finance (NIBAF)

Riaz Riazuddin, Economic Advisor, State Bank of Pakistan

Saleemullah, Director BSC & DFSD, State Bank of Pakistan

Sheikh Ashraf, Chief Manager Recovery, Punjab Provincial Cooperative Bank

Syed Irfan Ali, Director Banking Policy and Regulation Department, State Bank of Pakistan

Syed Mohsin Ahmed, CEO Pakistan Microfinance Network

Tahir Ali Shah, Consultant Ministry of Finance and former ZTBL

Zulfikar Khokhar, Joint Director Microfinance Department, State Bank of Pakistan

Policy Annexure

POLICY ANNEX 1: REPORT ON THE ACAC JULY 2007

The State Bank Governor directed the Task Force to undertake the following tasks:

- Development of agricultural data base in conformity with international standards and development of methodology for proper estimation of the agriculture and rural credit requirements of the country in conformity with the overall agricultural production as set by the respective ministries;
- Preparing a holistic development strategy for enhancing rural financing whereby the development programs launched by federal and provincial ministries would be supportive of facilitating effective intermediation of agriculture and rural credit delivery; **and**
- To develop guidelines for lending technology and supportive credit enhancement mechanisms.

Governor SBP asked all stakeholders including banks, relevant federal ministries, provincial government departments and farmers' associations to make coordinated efforts; to increase agricultural credit absorption capacity as otherwise it would be difficult for banks to meet future targets of agricultural credit. The Committee was informed that the State Bank has developed a multi-pronged approach to double the outreach in terms of the number of borrowers and increase aggregate disbursements by banks of agricultural loans to meet up to 75% of the credit requirements of the sector, from the existing 45%, in the next three to four years. The following measures were discussed for further increasing the pace of growth of agricultural credit disbursement.

1. Each bank, SBP, Ministry of Food, Agriculture & Livestocks (MINFAL), provincial agriculture departments, extension services departments, revenue boards, Pakistan Agriculture Research Council and other stakeholders prepare individual activity plans (sub-strategies) along with timelines, duly approved at the highest level, and share the same with SBP to ensure collaborative efforts.
2. Government needs to provide a level playing field for all banks by bringing ZTBL and PPCBL on market-based systems.
3. Introduction of mandatory crop loan insurance scheme.
4. Effective implementation of ADB Agribusiness Project for capacity building of banks in agribusiness lending.
5. Mass media campaign and specialized incentives for employees entrusted related tasks for 3-5 years.
6. SBP and MINFAL to develop data base covering information/data on the basis of districts, farm/non-farm sector, agribusinesses, export markets, number of households, etc.
7. Periodic surveys and studies by SBP, MINFAL and provincial agriculture departments to take stock of the implementation in ongoing initiatives.
8. Publication of a newsletter to share developments, achievements and initiatives of stakeholders.

The Governor asked the commercial banks to focus on non-farm credit which will not only enhance their credit portfolios but also help to generate employment in the rural areas. She stressed that banks in consultation with other stakeholders should develop new and innovative loaning products to cater to the demand of the sector.

POLICY ANNEX 2: REPORT ON THE ACAC JULY 2007 – PERFORMANCE

A press release on the ACAC's July 2007 meeting summarized the performance of the banking sector against targets of agri-credit, and future course of action as:

- State Bank of Pakistan Governor Dr Shamshad Akhtar said here on Saturday that the central bank had set an indicative credit disbursement target of Rs 250 billion for agriculture sector for the current fiscal year 09.
- This can be further enhanced after having a detailed analysis of the rising input costs of the sector, said an SBP statement here.
- Presiding over a meeting of the Agricultural Credit Advisory Committee at the SBP Head Office, Dr Akhtar commended the performance of banks that played a significant role in surpassing the target set for the last fiscal year.
- Dr Akhtar informed the meeting that in 2007-08 banks surpassed the agriculture credit target of Rs 200 billion and disbursed Rs 212 billion to the farming community which is higher by Rs 43 billion or 25pc than the last year's disbursement of Rs 169 billion.
- She said that keeping in view the growing requirements of the sector, the State Bank has proposed an indicative target of Rs 250 billion for 2008-09, which is higher by Rs 50 billion or 25pc than last year's target and Rs 38 billion or 15pc higher than the actual disbursements of FY08.
- Dr Akhtar appreciated the fact that sector-wise agriculture credit disbursements during the last fiscal year showed diversification of the credit to non-farm sector as its share in the total credit disbursement increased to 25pc in FY08 from 17pc in Fy07. She pointed out that recoveries of agriculture loans have shown significant improvement during FY08 and banks recovered 92pc of their recoverable amounts as against 83pc recovered during FY07.
- While responding to questions from by representatives of three less developed provinces on lower disbursement of agriculture loans to their respective provinces, the SBP governor said that the banks are making efforts which have resulted in an increase in disbursements during the last couple of years.
- The delegates pointed out that there are issues of credit absorption in the provinces because of low productivity, water salinity, lack of good farming practices by the farmers and other issues that need to be addressed by various provincial agriculture and extension services departments to create an enabling environment for banks to increase their outreach. Dr Akhtar urged the representatives of the three provincial governments to take necessary steps to address these issues and improve coordination between respective departments on fast-track basis to increase the flow of agriculture credit to the less developed areas of the country.
- The SBP governor also informed the meeting about the recently launched crop loan insurance scheme developed by the SBP task force that would be implemented from coming Rabi crop.
- To facilitate small farmers, the government has agreed to share the premium cost of subsistence farmers. She asked banks to adequately publicise the scheme for the benefit of farmers.
- It is hoped that banks would also adjust their agriculture loan pricing following introduction of the scheme as it would mitigate their risk of losses due to natural calamity, she added.
- Dr Akhtar briefed the committee about State Bank's initiative of introducing guidelines on Islamic financing for agriculture.

- She urged all stakeholders to effectively publicise the scheme for creating awareness among the farming community.
- The representatives of the farming community, appreciating the efforts of State Bank and commercial banks in increasing the flow of credit to farming community, highlighted the issues pertaining to low quality seeds, acute shortage of fertilisers, water scarcity and lack of marketing channels.
- They suggested to the committee to take up these issues with concerned federal and provincial government departments so that the farming community can utilise banks' credit efficiently.
- The Executive Director, State Bank of Pakistan, Jameel Ahmed, informed the meeting that as per approved plan the banks would open 600 branches during 2008, 20pc of which would be in rural areas.
- Dr Shamshad said that the SBP would encourage banks to open as many number of branches as they like in rural un-served areas in addition to approved plan.
- The banks briefed the committee on their respective initiatives which inter alia include increase in number of agriculture lending branches, increase in agriculture credit officers, introduction of innovative lending products for farm and non-farm activities and a number of awareness programmes conducted throughout the country.
- Dr Shamshad Akhtar informed the committee about the introduction of a scheme under the DFID-funded Financial Inclusion Programme whereby the banks can provide wholesale credit to microfinance banks for onward disbursement to micro borrowers of rural areas against the credit enhancement guarantee scheme..
- She said that the initiative would facilitate government efforts to alleviate poverty and also increase access to credit to rural/farming community, besides banks can contribute to enhancing agriculture credit disbursement through a network of microfinance institutions.

Source: APP

POLICY ANNEX 3: TIME LINE OF AGRICULTURAL FINANCE POLICY

September 2008: Crop Loan Insurance Scheme Launched

The scheme would provide cover to the borrowers against their losses due to natural calamities up to the amount of the outstanding loan and mark up thereon. The insurance companies will charge a maximum of 2% premium for all major field crops and the risk is covered against excessive rains, hail, frost, flood, drought, and crop related diseases like viral and bacterial attacks or damage by locusts. The scheme will be mandatory for the borrowers of the banks. Simultaneously, the Federal ministry of Finance is working on the operational framework for payment of insurance premium by the government on behalf of small farmers.

March 2008: Branchless Banking Regulations for Financial Institutions

Branchless Banking represents a convenient alternative to conventional branch-based banking that allows financial institutions and other commercial players to offer financial services outside traditional bank premises by using delivery channels like retail agents, mobile phone etc. In view of encouraging innovation and increasing outreach of the banking system, the State Bank of Pakistan has decided to issue Branchless Banking Regulations.

March 2008: Guidelines on Poultry Financing

Keeping in view the increasing demand for credit to poultry, SBP in consultation with stakeholders developed guidelines on poultry financing to facilitate banks in developing specific products and to increase the flow of credit to this sector.

January 2008: Financing Scheme for Small Farmers

In order to improve the access to finance to the small farmers involved in crop and non-crop activities who are unable to provide adequate collaterals according to the requirements of banks, SBP has designed a financing scheme for them on the group based lending methodology. Under the scheme, banks shall provide loans to the members of small farmers' groups for crop and non-crop activities, based on their cash flow under joint cross guarantee of group members.

December 2007: Guidelines on Horticulture Financing

The government is taking several initiatives for the development of horticulture sector and its value chain. Therefore, keeping in view the increasing credit demand for this sector, SBP in consultation with stakeholders has developed these guidelines to facilitate banks in developing specific products to increase the flow of credit to the horticulture.

October 2007: Branch Licensing Policy

At least 20% of the additional branches planned to be opened by a bank under its Annual Branch Expansion Pan shall be opened in Rural Underserved Areas.

March 2007: Revised Prudential Regulations for Microfinance Banks

The current changes in Prudential Regulations for MFBs mainly relate to increase in maximum loan size, investment of surplus fund, minimum income threshold, submission of audited financial statements, and declaration of Fidelity and Secrecy.

March 2007: Guidelines for Fisheries Financing

In order to facilitate the banks/DFIs to increase the flow of credit to this sector, SBP has developed guidelines for fisheries financing in consultation with key stakeholders including fisheries departments, fishermen cooperative societies, chambers of agriculture, farmers associations, agriculture research institutions, banking sector and MINFAL.

August 2006: Guidelines for Livestock Financing

The SBP established a Committee of Experts in August, 2005 to devise a strategy for increasing the share of institutional finance to this sector. The guidelines cover all areas of the livestock financing business including loan purpose and objectives, product development, eligibility of borrowers, delivery channels, monitoring mechanism etc. With the issuance of these guidelines, Banks/FIs are expected to considerably enhance the credit flow to this important sector. Banks may adopt the guidelines in its present form or with some modifications that suit their organizational needs and market characteristics.

March 2002: Distribution of Mandatory Credit Targets into Production and Development Loans.

The existing maximum limit of 15% for development loans against the total mandatory credit targets was withdrawn. Banks are now free to extend development loans as well as production loan to other than small farmers up-to 50% of their agriculture targets subject to the condition that they shall ensure to make financing of the remaining 50% of their mandatory credit targets to small farmers for production/crop loans.

April 2001: Revolving Credit Scheme for Agriculture

Revolving Credit Scheme" was introduced on the recommendation of all participating banks as well as Chambers of Agriculture and Farmers / Growers Associations. The spirit behind the introduction of the said scheme was to facilitate the farming community to avail credit without repeated documentations, bank visits and approvals of the limits against full repayments.

2001: Revamping of Supervised Agricultural Credit Scheme

On the initiatives of commercial banks under the leadership of Muslim Commercial Bank Limited. It was decided to withdraw the restrictions on commercial banks for making disbursements only within their respective territorial jurisdictions, i.e., Union Councils/Town Committees allocated to them. Fourteen new Domestic Private Banks were inducted in the Agricultural Loans Scheme and indicative targets were allocated to them for the year 2001-02.

1986: Supervised Agricultural Credit Scheme

This scheme was developed as the ACAC observed that agricultural credit disbursed by Nationalized Commercial Banks was being diverted to non-agricultural purpose and the position of recovery of these loans was not satisfactory. Pakistan Banking Council was asked to allocate territorial jurisdictions to Nationalized Commercial Banks for implementing the Scheme. The allocation of territorial jurisdiction among the Nationalized Commercial Banks was made on tehsil wise basis in consultation with banks.

1973: Methodology Developed for Preparation of Agriculture Credit Requirements

The ACAC, with the assistance of Committee of Experts appointed by it, evolved a methodology for the preparation of estimates of agricultural credit requirements. This methodology is now revised from time to time.

1972: Agriculture Credit Advisory Committee Established

The Agricultural Credit Advisory Committee (ACAC) was set up to assess credit requirements of the agriculture sector in order to assist the National Credit Consultative Council (NCCC) in the preparation of the Annual Credit Plan and to consider the ways and means for improving the disbursal and recovery of agricultural credit together with suggesting measures for the strengthening of institutional framework of agricultural credit.

1972: Agricultural Loan Scheme Launched

In the absence of adequately developed specialized institutions for this sector, commercial banks, with their large network of branches, were inducted in mandatory agricultural financing under this Scheme.

1956: Creation of Agriculture Credit Department:

In compliance with the provisions contained in Section 8 (3) of the SBP Act 1956, State Bank of Pakistan, has to ensure availability of the adequate and timely banking credit to the Agricultural Sector, besides creating awareness and uplifting the living standard of the rural community. For this purpose an Agriculture Credit Department was created.

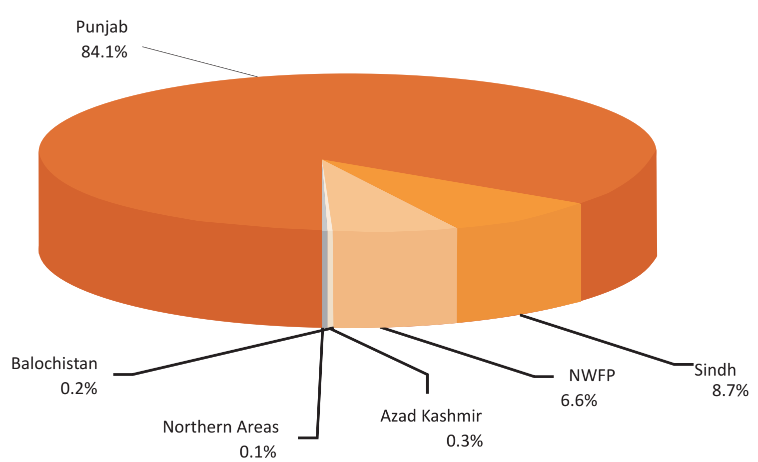
POLICY ANNEX 4: GRAPHICAL ANALYSIS OF BANKS' AGRICULTURE CREDIT PORTFOLIO[34]

(July 2007 – June 2008)
(Amount in millions)

	Farm Sector		Non-Farm Sector	
	No. of Borrowers	**Disbursement**	**No. of Borrowers**	**Disbursement**
Punjab	1,006,538	130,221.031	67,949	46,154.186
Sindh	104,557	20,273.830	3,585	4,383.470
NWFP	79,584	8,219.886	9,755	901.182
Baluchistan	1,971	563.477	74	99.456
Azad Kashmir	3,025	200.221	8,014	292.312
Northern Areas	1,413	196.989	1,043	54.616
All Pakistan	**1,197,088.000**	**159,675.434**	**90,420.000**	**51,885.222**

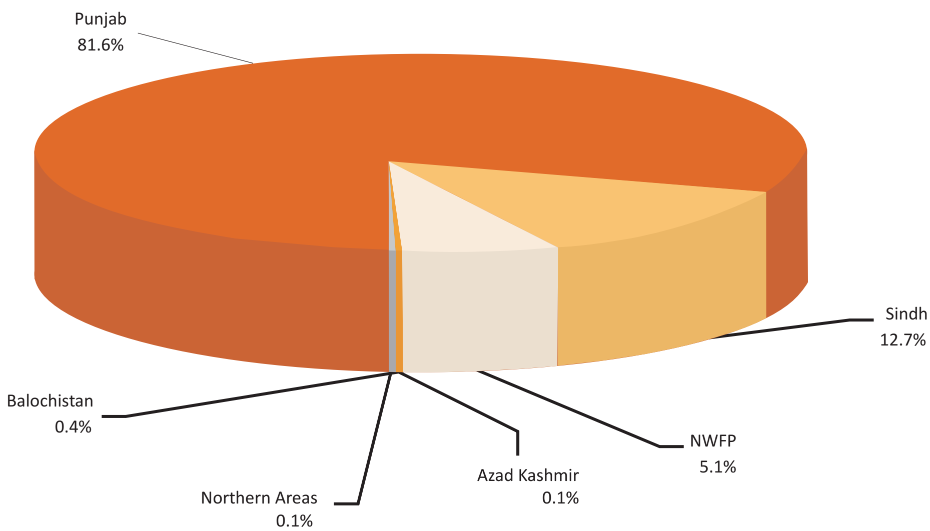
I. FARM SECTOR

Provincial Distribution of Borrowers (Farm)

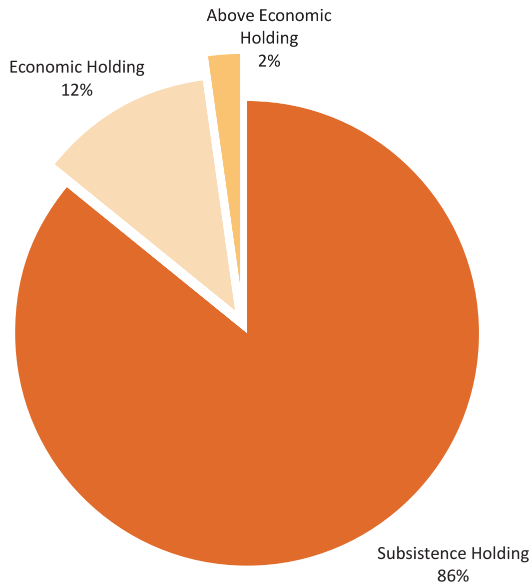


34. Source: SBP

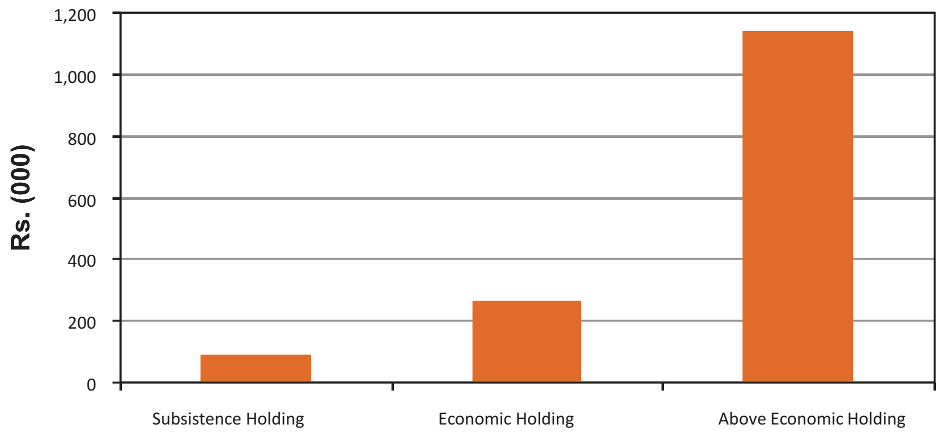
Provincial Distribution of Disbursement (Farm)



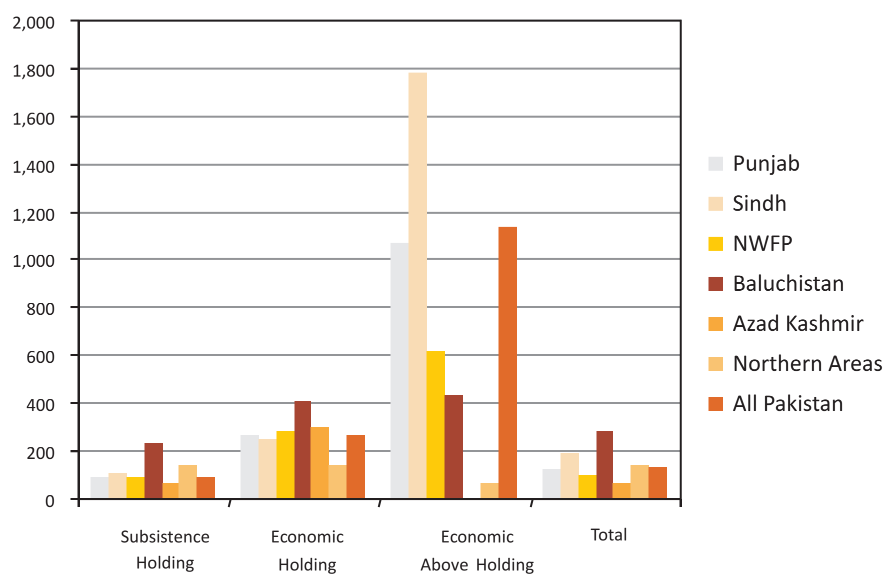
Farm Sector Borrowers by Size of Land Holding



Average Loan Size by Size of Land Holding (Farm)

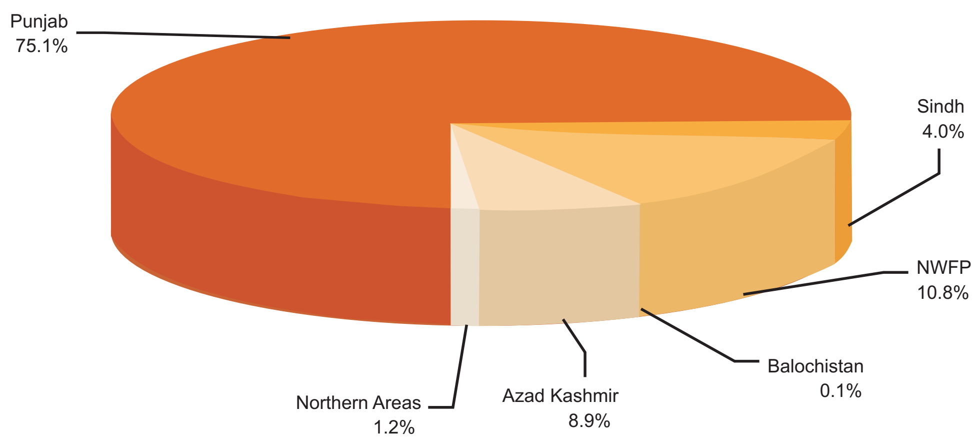


Average Loan Sizes by Province & Size of Land Holding

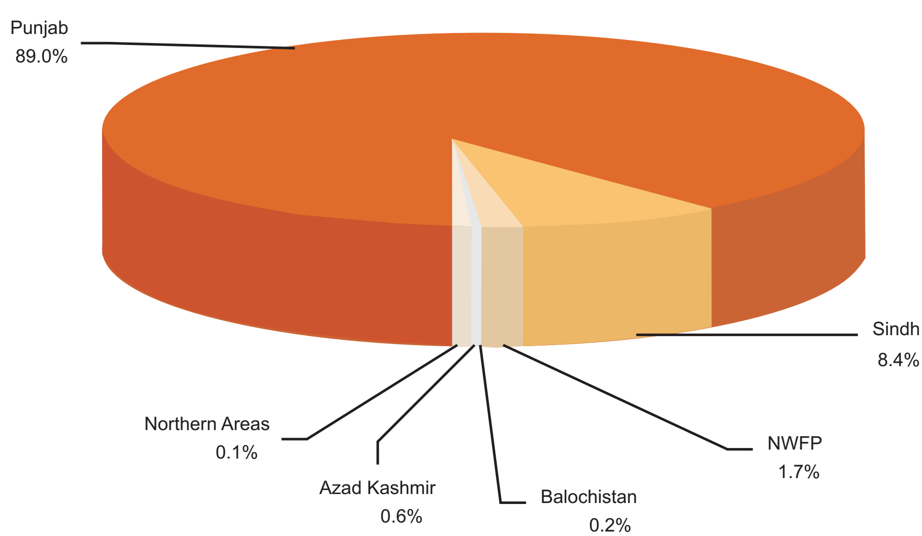


II. NON-FARM SECTOR

Provincial Distribution of Borrowers (Non-Farm)

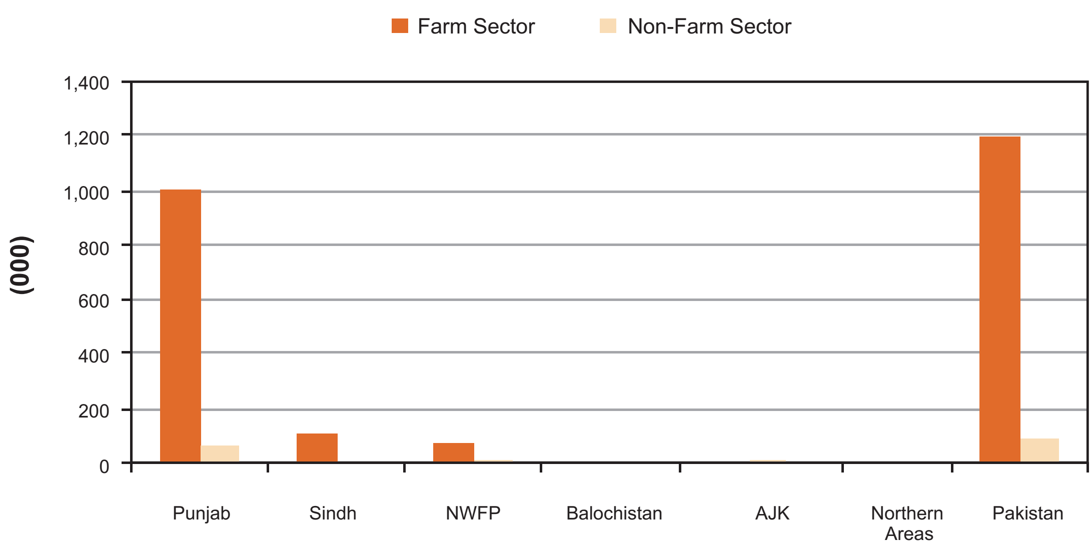


Provincial Distribution of Disbursement (Non-Farm)

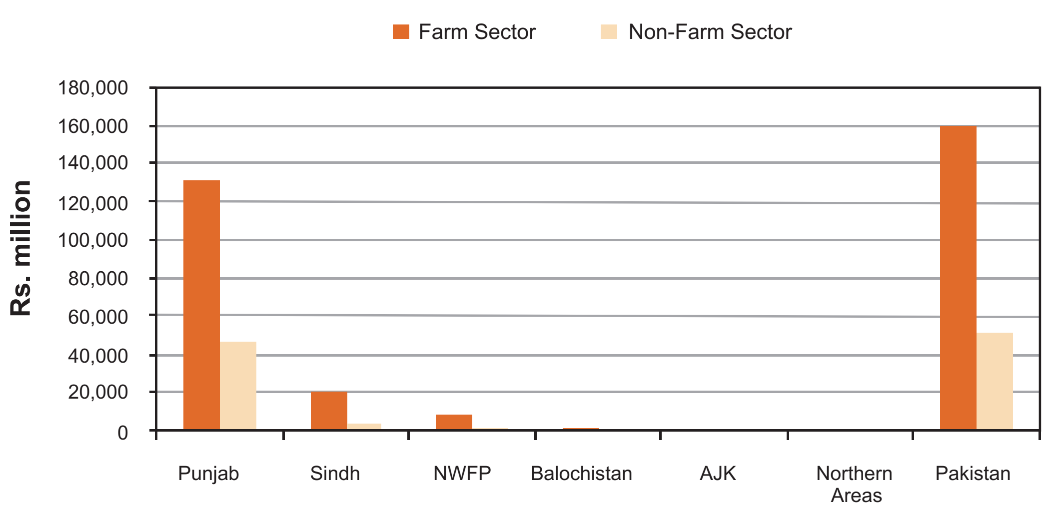


III. COMPARING FARM & NON-FARM SECTORS

Comparing No. of Borrowers in Farm and Non-Farm Sectors



Comparing Disbursement in Farm and Non-Farm Sectors



POLICY ANNEX 5: CIRCULARS REGARDING THE SUPERVISED AGRICULTURE CREDIT SCHEME

April 2008: Awareness among the Farming Community

In order to increase outreach of agriculture financing, banks need to create awareness among the farming community about their designated branches involved in agriculture financing and agricultural loan products being offered by them. In this regard, banks are advised to take the following steps:-

- Display outside the premises of their branches engaged in agriculture finance that “Agri. Loans Are Available Here” in Urdu and/or regional languages.
- Make arrangements for availability of information in Urdu and/or regional languages in the form of brochures inside their agri. financing branches about their agriculture. loan products, eligibility criteria, collateral requirements, terms and conditions, etc. and the same may also be displayed on the notice board of the branches.
- List of all designated agri. credit branches along with names, contact details, and salient features of schemes/products being offered by banks for agricultural financing shall be placed on bank's website.
- Banks are advised to comply with the above instructions by 5th May, 2008, failing which penal action will be taken under Banking Companies Ordinance, 1962.

March 2008: Branchless Banking Regulations for Financial Institutions

Branchless Banking represents a convenient alternative to conventional branch-based banking that allows financial institutions and other commercial players to offer financial services outside traditional bank premises by using delivery channels like retail agents, mobile phone etc. In view of encouraging innovation and increasing outreach of the banking system, the State Bank of Pakistan has decided to issue the enclosed Branchless Banking Regulations. These Regulations will be applicable to banks including Islamic banks and Microfinance banks (MFBs) with immediate effect.

March 2008: Guidelines on Poultry Financing

Keeping in view the increasing demand for credit to poultry, SBP in consultation with stakeholders has developed the attached guidelines on poultry financing to facilitate banks in developing specific products and to increase the flow of credit to this sector.

Banks are advised to use the guidelines for developing their own products for financing to poultry sector according to their credit policy and operational & market requirements, subject to compliance with SBP regulations for agriculture financing.

January 2008: Financing Scheme for Small Farmers - Amendment

Please refer to ACD Circular No. 01 dated 1st January, 2008 on the captioned subject.
In this regard, on representations from farming community of Sindh & Balochistan, following amendments have been made:

- For the purpose of farm credit, the eligibility criterion of small farmers of Sindh & Balochistan has been extended up to 16 & 32 acres of land respectively instead of 12.5 acres.
- Working capital requirements under heading 2.5 may be read as “working capital and term finance requirements.
- The “NIC #” against Appendix I & III may be substituted as “CNIC #”.

January 2008: Financing Scheme for Small Farmers

In order to improve the access to finance to the small farmers involved in crop and non-crop activities who are unable to provide adequate collaterals according to the requirements of banks, SBP has designed a financing scheme for them on the group based lending methodology. Under the scheme, banks shall provide loans to the members of small farmers' groups for crop and non-crop activities, based on their cash flow under joint cross guarantee of group members.

The scheme covers all areas of the group based financing methodology including group formation, roles & responsibilities of members, bank & group coordinator, size and tenure of loans, documentation and other related matters. Financing to small farmers under the scheme shall be subject to compliance with SBP regulations on agriculture financing. Copy of the scheme is attached.

December 2007: Guidelines on Horticulture Financing

Pakistan's horticultural produce including fruit, vegetables, flowers and ornamental plants have great demand in both domestic and export markets. The government is taking several initiatives for the development of horticulture sector and its value chain. Therefore, keeping in view the increasing credit demand for this sector, SBP in consultation with stakeholders has developed the attached “Guidelines on Horticulture Financing” to facilitate banks in developing specific products to increase the flow of credit to the horticulture.

The Guidelines provide details about horticulture including financing to fruit, vegetables, flower & ornamental plants production. It also provides eligibility criteria for borrowers, types of financing, collateral requirements, fixation of loan limit, repayment terms, loan monitoring mechanism, etc. Banks may adopt the guidelines in the present form or with some adjustments to suit their organizational & operational needs and market characteristics, subject to compliance with SBP's regulations for agriculture financing.

October 2007: Revised Branch Licensing Policy

State Bank of Pakistan (SBP) since 2002 has liberalized the Branch Licensing Policy (BLP) with a view to allow the banks to make their branch housing decision within the broad policy parameters. The changes have also been made with the aim to enhance the outreach of banking services to rural/underserved areas of the country. SBP continuing with its above endeavor has revisited the existing BLP with the following objectives:-

Consolidate existing policies/instructions issued on branch licensing including opening of branches abroad, opening of branches by MFBs, and DFIs, shifting of branches, annual fee, etc.

Amend the existing instructions for opening of 20% branches in rural/underserved areas for the purpose of enhancing the outreach of banking services.

Introduce new features/options for opening of sub-branches, sales & service centers and mobile banking units.

Simplify the forms for submission of various applications for licensing, shifting, closing, etc of branches.

Rationalize some of the existing instructions for ensuring statutory/regulatory compliance.

March 2007: Revised Prudential Regulations For Microfinance Banks (MFBs)

Please refer to BSD Circular No. 18 dated October 14, 2002 regarding Prudential Regulations for Micro Finance Banks (MFBs).

As you are aware Microfinance Banking in Pakistan has witnessed a considerable growth in recent years. However, keeping in view the existing large unmet demand in Microfinance sector and the need for strengthening institutional capacities of MFBs, certain changes in the existing legal & Regulatory framework have been made. It may be noted that some amendments have already been made in MFIs Ordinance 2001 through Finance Bill 2006.

The current changes in Prudential Regulations for MFBs mainly relate to increase in maximum loan size, investment of surplus fund, minimum income threshold, submission of audited financial statements, and declaration of Fidelity and Secrecy. The revised Prudential Regulations for MFBs are enclosed which will come into force with immediate effect.

March 2007: Guidelines for Fisheries Financing

Fisheries is an important sub-sector of agriculture. Pakistan with a coastline of more than 1000 km and a total area of approximately 0.25 million sq km of marine and 0.08 million sq km of inland waters, has great potential for fisheries that can play a significant role in the national economy by contributing towards food security of the country, reducing pressure on demand for mutton, beef and poultry and earning of foreign exchange. Fisheries sector is providing direct employment to about 379,000 fishermen and 400,000 people are employed in ancillary industries. It has a domestic consumption potential of 1 million metric tonnes and export of US$1 billion annually. However, the flow of bank credit to this sector is negligible i.e. 0.4% of the total agricultural credit disbursement.

In order to facilitate the banks/DFIs to increase the flow of credit to this sector, SBP has developed guidelines for fisheries financing in consultation with key stakeholders including fisheries departments, fishermen cooperative societies, chambers of agriculture, farmers associations, agriculture research institutions, banking sector and MINFAL.

The Guidelines cover all areas of the fisheries financing including purposes and objectives of the loan both for marine and inland fisheries, eligibility of borrowers, types of financing, fixation of loan limit, repayment terms, loan monitoring mechanism, etc. Banks may adopt the guidelines in the present form or with some adjustments to suit their organizational & operational needs and market characteristics, subject to compliance with SBP Prudential Regulations for agriculture financing.

August 2006: Guidelines for Livestock Financing

Livestock is the largest sub-sector of the agriculture accounting for 47 percent of value addition in the sector and constitutes about 11 percent of the GDP. The disbursements to the agriculture sector have witnessed significant growth during the last few years as a result of sector friendly policies of State Bank of Pakistan and efforts of the commercial banks. However, the livestock sub-sector could not get the due share in the substantially enhanced flow of credit to the Agriculture sector.

In view of the contribution of the livestock sector to GDP & employment creation especially in rural areas, SBP established a Committee of Experts in August, 2005 to devise a strategy for increasing the share of institutional finance to this sector with huge growth potential. In light of the recommendations of the Expert Committee and input from the stakeholders including banking sector and MINFAL, SBP has framed 'Guidelines for Livestock Financing' to facilitate and encourage Banks/FIs in enhancing credit flow to the livestock sector. The guidelines cover all areas of the livestock financing business including loan purpose and objectives, product development, eligibility of borrowers, delivery channels, monitoring mechanism etc. With the issuance of these guidelines, Banks/FIs are expected to considerably enhance the credit flow to this important sector of the economy. Banks may adopt the guidelines in its present form or with some modifications that suit their organizational needs and market characteristics.

March 2005: Agricultural Loan Scheme- List of Eligible Items for Agricultural Credit

In order to enhance the scope of Agricultural Loans Scheme and to ensure availability of adequate and timely credit to agriculture sector, the Agricultural Credit Advisory Committee (ACAC), in its mid-term meeting held on February 1, 2005 at SBP Karachi has decided to include the following item in the list of items eligible for credit under SBP Supervised Agricultural Credit Scheme:

Poultry Feed Making Industry, credit requirement-75 % of the cash requirement (same ratio as of Compound Feed Making Industries under livestock).

August 2004: Revised Indicative Per Acre Credit Limit for Major Crops

With a view to facilitate the farming community in the matter of availability of adequate and timely banking credit for meeting their genuine needs, it has been decided by the Agricultural Credit Advisory Committee (ACAC) in its annual meeting held on 17th July, 2004 to enhance the per acre credit limits for the following four major agriculture crops with immediate effect.

	Crops	Existing limit Rs. (per acre)	Revised limit Rs. (per acre)
1	Sugar	8,000	16,000
2	Paddy	4,500	7,000
3	Wheat	4,000	6,600
4	Cotton	6,000	10,000
5	Other Crops	As per actual cost	As per actual cost

Note : These limits are only indicative and banks are free to lend more or less of these indicative limits depending upon actual assessment at the time of lending.

October 2003: Revolving Credit Scheme For Agriculture

It may be recalled that while enhancing/revamping the scope & eligibility criteria under the Supervised Agricultural Credit Scheme circulated vide our circular No. ACD/1035-1039/PD (P) –08/2001 dated 25th April 2001, a scheme namely “Revolving Credit Scheme” was introduced on the recommendation of all participating banks as well as Chambers of Agriculture and Farmers/Growers Associations. The spirit behind the introduction of the said scheme was to facilitate the farming community in timely availement of credit without repeated documentations, bank visits and approvals of the limits against full repayments.

Since introduction of the said scheme, various difficulties and complaints were observed in its implementation and adoption of different definitions and procedures by each bank. In order to implement the Revolving Credit Scheme smoothly and uniformly, it was decided by the Agricultural Credit Advisory Committee (ACAC) at its meeting held on 4th July 2003, to develop uniform and standardized definition and procedure, for banks under Agricultural Loans Scheme in consultation/consensus with all the participating banks. Accordingly the scheme has been developed with the salient characteristics as three years revolving credit with automatic renewal, one time documentation, partial repayments and annual cleaning of account (Principal and Markup) at any date convenient to the Borrower. Major Commercial Banks (ABL, HBL, MCB, NBP and UBL), Domestic Private Commercial Banks, Zarai Taraqiati Bank Ltd. (ZTBL) and Punjab Provincial Cooperative Bank Ltd. (only for lending to individuals) are therefore, advised to introduce the enclosed “Revolving Credit Scheme” for Agriculture Credit with immediate effect as per annexure-A.

individuals) are therefore, advised to introduce the enclosed “Revolving Credit Scheme” for Agriculture Credit with immediate effect as per annexure-A.

Efforts have been made by the State Bank of Pakistan to develop a uniform definition and procedure of the said scheme, in accordance with the provisions of Banking Laws and Practices, including Prudential Regulations and without compromising the security and interest of the lending banks and privileges of the farming community under the enhanced scope of Agricultural Credit Scheme. The definition and procedure of the scheme shall remain unchanged for all the participating banks.

August 2003: Standardization and Simplification of Agricultural Credit Documents

On the recommendations of the Committee for Standardization/Simplification of Agricultural Credit Documents, constituted under the Chairmanship of Muslim Commercial Bank Limited and Habib Bank Ltd., as its Secretary along with all heads of Agricultural Credit Departments/Divisions of National Bank of Pakistan, United Bank Ltd., Allied Bank of Pakistan Ltd., Zarai Taraqiati Bank Ltd. (former ADBP), Bank Al-Habib Ltd., Askari Commercial Bank Ltd., Bank of Khyber Ltd., Bank of Punjab Ltd., as members and State Bank of Pakistan as Coordinator, the following revised/standardized/simplified documents have been accepted unanimously for financing of different categories of agricultural loans.

The Revised IB-7 (appended as Annexure-A) was approved as a common and uniform charge form, which covers all legal aspects of the financing and applicable for Demand Finance, Running Finance and Revolving Credit (repayable for a period of three years in full with mark-up each year), to be implemented/adopted by all Commercial Banks and Domestic Private Banks immediately.

The Revised Loan Application Form (in Urdu, containing Borrowers Basic Facts Sheet) was also accepted as a common and uniform Application Form (appended as Annexure-B) to be implemented/adopted by all Commercial Banks and Domestic Private Banks immediately.

The Committee agreed to use the list of common documents (appended as Annexure-C) in uniformity, in addition to the Revised IB-7 and the Revised Loan Application Form.

In order to maintain the uniformity and to facilitate the farming community, all major Commercial Banks (ABL, HBL, MCB, NBP & UBL) and Domestic Private Commercial Banks are advised to adopt/use/introduce the enclosed Standardized/Simplified/Revised Agricultural Credit Documents for Agricultural loaning purposes, as developed in consensus with all Commercial Banks, under their respective Bank's name and Monogram, with immediate effect.

Efforts have been made by the Committee and by the State Bank of Pakistan to revise the agricultural credit documents strictly in accordance with the provisions of banking laws and practices, including Prudential Regulations and without compromising the security and interest of the banks and privileges of the farming community under the enhanced scope of agricultural credit. However, if the banks desire to ask for more information, the same may be done through the same process, i.e., should be discussed in the above Committee and after the approval of the State Bank of Pakistan.

November 2002: Encouragement Of Mechanized Farming-Financing For Tractors

It is clarified for the guidance of all the banks involved in disbursement of agricultural credit that there is no restriction on the banks to provide agricultural loans to the farmers having subsistence holdings i.e. Punjab & NWFP (up to 12.5 Acres), Sindh (up to 16 Acres) and Balochistan (up to 32 Acres) for purchase of new/used tractors subject to completion of required formalities.

You are requested to please ensure that all necessary steps are taken to encourage mechanized farming in the country by making tractor financing to the needy farmers.

September 2002: Supply of Data on Financing of Tractors

As you are aware, the Domestic Private Banks (DPBs) have been involved in agricultural financing since last year. We hope that like other commercial banks your bank would also be taking active part in enhancing mechanized farming in the country. Five major commercial banks (ABL, HBL, MCB, NBP, UBL), ADBP & FBC/PCB (Punjab) are already providing us the information on monthly basis in respect of the finance provided by them to the needy farmers for purchase of tractors. In order to obtain a uniform data on financing of tractors from the banking sector, you are requested to provide us the said information in respect of your bank on the revised performa.

August 2002: Agricultural Loan Scheme-List of Eligible Items for Agricultural Credit

In order to further enhance the scope of Agricultural Loans Scheme and to ensure availability of adequate & timely credit to the growers/farmers, the Agricultural Credit Advisory Committee (ACAC), in its meeting held on 17th July 2002 at SBP, Karachi, has taken the following decisions with immediate effect:

Finances made by the banks to the Leasing Companies for providing agricultural equipments/machines on leasing/rental/hiring basis to the growers/farmers shall be treated as part of banks' mandatory targets for agriculture.

Banks are allowed to provide finances for processing of high quality seeds to the Seed Processing Units. Such financing shall also be treated as part of banks' mandatory targets for agriculture.

June 2002: Wheat Procurement by the Private Sector

Please refer to ACD Circular No. .01/PD(P)-08/2002 dated the 16th January, 2002 read with BSD Circular letter No. 33 dated the 3rd December, 2001 regarding disbursement of Agricultural Loans by the banks to the farmers/flour mills for construction of wheat godowns/silos in the country and deregulation of Wheat Trade.

In this connection certain points were raised by the banks while implementing the provisions of the above circulars. These points have been examined and following clarifications are issued for the guidance of the banks:

POINTS	CLARIFICATIONS
It is not clear from the above referred circulars as to what rate of mark-up should be applied on financing for construction of storage facilities, as the BSD Circular has advised charging of markup at normal lending rate whereas the ACD Circular has advised 12 % rate of markup which will be subsequently made market based?	Banks are allowed to provide financing facility to private sector for wheat procurement at markup rate of 12 % p.a. as already advised, vide BSD Circular letter No. 33 dated the 3rd December, 2001.However, financing for a maximum period of 7 years can also be provided by the banks for construction of silos and other structures that can serve as storage area for wheat at a debt equity ratio of 60:40 at normal lending rates.
Please also clarify if the traders, commission agents and other entities are also eligible for financing for procurement of wheat/construction of storage facilities at the same lending rate as is applicable to growers and flour mills?	The Wheat Traders who are involved in procurement of wheat are also eligible for availing financing facility for procurement of wheat at 12% p.a. markup rate, vide No. BPD (RU-50)/911(16)/5449/2002 dated the 12th April, 2002. Wheat Traders are also entitled to avail financing facilities for construction of storage facility for wheat at normal lending rate as already advised, vide BSD Circular letter No. 33 dated the 3rd December, 2001.

Finances made by the banks to the Leasing Companies for providing agricultural equipments/machines on leasing/rental/hiring basis to the growers/farmers shall be treated as part of banks' mandatory targets for agriculture and Banks are allowed to provide finances for processing of high quality seeds to the Seed Processing Units. Such financing shall also be treated as part of banks' mandatory targets for agriculture.

April 2002: Wheat Procurement by the Private Sector

It has been reported by the various quarters i.e. Farmers' Association, Chambers of Agriculture, Associations of Flour Mills that the banks are not found serious in the disbursement of Agricultural loans for construction of wheat godowns/silos as yet. Such attitude on the part of banks has been viewed as a great concern by the State Bank due to national cause and the same is not reflecting healthy symptom for marketing/procurement of wheat crop rendering financial loss to the growers/flour mills in the form of receipt of lower prices of their agricultural produce to sell immediately for want of storage facilities.

March 2002: Distribution of Mandatory Credit Targets into Production and Development Loans.

In order to meet the increased demand for development loans under the Agricultural Mandatory Credit Targets of the commercial banks, it has been decided to withdraw the existing maximum limit of 15% for development loans against the total mandatory credit targets (Main Agriculture) of a bank fixed by the State Bank of Pakistan with immediate effect. This relaxation has, however, been made initially for a period of one year ending 30th June, 2003. Banks are now free to extend development loans as well as production loan to other than small farmers up to 50% of their targets (Main Agriculture) subject to the condition that they shall ensure to make financing of the remaining 50% of their mandatory credit targets to small farmers for production/crop loans.

January 2002: Wheat Procurement by the Private Sector

It has been observed that storage facility for wheat is inadequate in the country since a long period, as such there is need to enhance the said facility as wheat is always on the top of major crops of our country. For procurement of such important food item, the Governor, State Bank of Pakistan, has been pleased to allow the banks to provide adequate funds/financing as agricultural loans for a period up to 5 - 7 years to eligible flour mills and farmers for the construction of silos and other structures that can serve as storage area for procurement of wheat at a debt equity ratio of 60:40 (Bank: Borrower) and 12% mark-up rate. The lending rates shall subsequently be made market based on their linkage with rate on T. Bills. The banks would ensure that the transactions are viable and their exposure is secured adequately. For the purpose, the Ministry of Food, Agriculture & Livestock (MINFAL) would develop standardized models for construction of storage facilities (of various sizes and types) making it possible for banks to concentrate on mitigating credit risk of the borrowing entity. Further, the storage financing would be counted towards achievement of Mandatory Agricultural Credit Targets of the banks on the basis of the outstanding stocks every year, as it would primarily be for long-term basis. However, the banks should ensure that the storage facility would be used at maximum level only for procurement of wheat by the borrowers.

List of Abbreviations

ACAC	Agricultural Credit Advisory Committee
ABL	Allied Bank Limited
ACD	Agriculture Credit Department
ADBP	Agricultural Development Bank of Pakistan
ALA	Agriculturists Loan Act
ADB	Asian Development Bank
CB	Commercial Banks
CRF	Committee on Rural Finance
DFI	Development Finance Institution
DFID	Department for International Development
FBC	Federal Bank for Cooperatives
HBL	Habib Bank Limited
KB	Khushhali Bank
LILA	Land Improvement Loans Act
MCO	Mobile Credit Officer
MFI	Microfinance Institution
MINFAL	Ministry of Food, Agriculture and Livestock
MSDP	Microfinance Sector Development Programme
NCB	Nationalized Commercial Banks
NCCC	National Credit Consultative Council
PPAF	Pakistan Poverty Alleviation Fund
PPCBL	Punjab Provincial Cooperatives Bank Limited
PERI	Punjab Economic Research Institute
PPCB	Punjab Provincial Cooperative Bank
RFSDP	Rural Finance Sector Development Program
SBP	State Bank of Pakistan
SDI	Subsidy Dependence Index
SMEDA	Small and Medium Enterprise Development Authority
UBL	United Bank Limited
ZTBL	Zarai Taraqiati Bank Limited

RURAL FINANCE POLICY IN PAKISTAN

ITS SCOPE, SOURCES AND IMPLICATIONS
FOR THE MICROFINANCE SECTOR

CONTACT INFORMATION

Pakistan Microfinance Network
132, Street # 40, F-10/4,
Islamabad, Pakistan.
Tel: +92 51 2292231, +92 51 2292270,
Fax: +92 51 2292230,
Email: info@pmn.org.pk
www.microfinanceconnect.info