

## **Farm Loans Recovery Problem in Pakistan: Its Possible Solution\***

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### **INTRODUCTION**

The emerging trend of focussing more and more attention on improving the production and productivity of farming in Pakistan has prompted bankers to evolve better schemes to improve the income generation capacity of the farming community and help them repay the borrowed funds in time. This can be called a step in the right direction. The Agriculture Development Bank of Pakistan (ADBP) the Federal Bank for Cooperatives (FBC) and the Commercial Banks are the major formal institutions, which because being Government owned have in fact become the agents for rural development purveying the most important input i.e. credit. Hence, the expansion and growth of the banking sector have become synonymous with national welfare. The main objective of banks in lending is to improve the recycling of funds capability borrowed from the public or raised from internal or external sources for the benefit of society. The recovery of loans portrays a dismal picture. Since agricultural lending expanded extensively, the recovery percentage has received a great setback due to which as per estimate more than half of the funds are not funnelled back. In fact, financial distress has always been a feature of the financial scene but most of the time it has been associated with being a sectoral problem such as those affecting agriculture and industries.

### **ITS NATURE**

There is a growing recognition among Pakistani farmers of the effect of improved inputs and new technology on agricultural yield. The use of these improved inputs and the adoption of the yield-inducing techniques have given rise to an increased demand for agricultural credit. Accordingly the government has established various types of financial institutions and it has also encouraged the

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development of credit schemes including the cooperative credit scheme, SACP, Agribusiness and the programme for the landless poor which is the focus of this paper. During the past four and a half decades financial services have expanded substantially in the rural areas. The provision of cheap credit is another measure besides introducing reforms in land tenure, subsidies on producer prices, research on technology appropriate to small farm resources and improved extension and technical support, has often encouraged upon governments as a means of stimulating production, specially among the rural poor. During the past four decades financial services have expanded substantially in rural areas. A number of problems tend to be associated with these activities. The first includes the widely recognised problems that are often associated with any business management and training difficulties. There is almost always a shortage of adequately trained people to fill positions in financial institutions. As a consequence, there is often slowness in making loan decisions, high cost lending operations, data processing problems, poorly designed loan payment procedures and lack of co-ordination between credit programmes and other development efforts. The second set of problems is much less widely recognised although probably more important. Serious loan repayment problems further reduce the viability of some loan portfolios. In many cases loan repayment problems emerge in all loan size groups. Further, it is often the case that financial markets resist lending to the agricultural sector. It is very difficult to serve the rural poor as such they prefer to lend to small farmers more strongly than they resist lending to agriculture in general specially for self-income generating activities on the basis of self-help or group lending. Typically formal credit institutions are badly fragmented. Each lender tends to service a narrow slice of the rural population. To solve this issue there is need to adopt an area approach without which effective loaning cannot be ensured. It is because of this reason they have also proved ineffective in mobilising local resources or tapping rural savings.

It has also been observed that some clients are forced to consume their "surpluses" or invest them in very low return activities while others must skip profitable investment opportunities because they lack additional liquidity. Thus it becomes difficult to introduce any innovations successfully. Typically, a promising innovation is tried by any of the formal credit institutions on a pilot project basis, but ultimately fails because it cannot reduce costs enough to overcome the effects on lender revenues of suppressed interest rates. These kinds of innovations typically increase rather than decrease costs.

The major focus needs to be laid on providing extension services for farmers, the landless and the artisans to motivate and to organise the population in the

planning and execution of development programmes to assist in agricultural research, to provide farm credit, to improve the marketing of farm products, and to participate in the extension of infrastructural programmes. The purpose of execution of credit plan is to increase the development capacity to assist farmers to increase agricultural production and income and to achieve a measurable impact on farmer productivity in four major aspects: Firstly to bring about expansion of the capacity of programme and outreach through devising a corporate plan, construction and equipment of improved central and field facilities and the provision of logistic support for field staff, the training of personnel and a programme of technical assistance. Secondly, it involves the generation of basic data through applied research related to traditional and improved farming systems, to credit requirements and alternative credit system to technical possibilities and economies of enterprises, and to marketing surpluses, marketing system and price fluctuations. Thirdly, it involves the testing of interventions, providing support mostly in the form of credit and a revolving fund for the purchase of cash crops. Fourthly, to find reasons of delinquency in loan repayment.

### THE RECOVERY PROBLEM

Overdue loan repayments are a serious problem among the farmers specially of large farmers generally speaking. Default in loan repayments by farmers is influenced by a variety of factors which have been broadly categorised into external and internal factors. The external factors, like natural calamities, are beyond the control of farmers. Admittedly the occurrence of a natural calamity and such other unfavourable factors causes more default and thus more indebtedness. At the same time; one can expect that given a favourable climate as is evidenced by normal and timely rainfall, the recovery can be comparatively easy. But it is often argued that even during normal conditions, the recovery of the loans is not adequate. For this state of affairs, there are certain plausible socio-economic factors like size of farm holding, ratio of dependents in the family to the total members of the family, total amount of loans borrowed, amount of loans used for nonproductive purposes, repaying capacity, increasing transaction costs etc. which influence the default of the farmers considerably. Thus, internal factors causing nonrepayment may be because of borrowings not utilised for productive purposes, which if used would generate a flow of income and help the farmers to repay the loans. Defaults on payment of loans taken from Public and Private Commercial Banks (PPCB) and Development Finance Institutions (DFIs) as per source have gone to above Rs 80 billion of which the share of the agrarian sector as estimated comes to more than

25 percent. Out of this default, to set up industrial projects has swelled by more than 70 percent in the last three years—from Rs 17 billion estimated upto April 1991 to over Rs 29 billion in April 1994. The bulk of the struck-up loans against closed units are virtually written-off loans. The fact is that there is very little chance of recovery of these loans unless government exercises pressure through the Corporate Law Authority. Further those defaulters who showed an inclination towards improving their repayment schedule, the banks and DFIs have provided them re-scheduling and re-structuring facilities. The main objective of banks in lending is recycling of funds borrowed from the public or raised from internal and external sources for the benefit of society. Since agricultural lending has expanded extensively, the recovery of specialised finance institutions actively involved in lending in the agrarian sector can be seen from the Table 1.

Table 1  
*Overdues and Recovery Situation During 8TH Plan Period*

(Rupees in Million)					
Institution/ Year	Demand	Collection	Balance	% Overdues to Demand	Overall Recovery (%)
Agri. Dev. Bank of Pakistan					
1988-89	8174.667	5211.467	2963.200	36.2	63.8
1989-90	10786.849	6579.672	4207.177	39.0	61.0
1990-91	13169.064	7808.523	5360.541	40.7	59.3
1991-92	17233.483	9438.104	7795.379	45.2	54.8
1992-93	14465.131	9019.159	5445.972	37.6	62.4
Total	63829.194	38056.925	25772.269	40.4	59.4
Federal Bank for Cooperatives					
1988-89	3060.500	2846.530	213.970	7.0	93.0
1989-90	2789.170	683.790	2105.380	75.5	24.5
1990-91	3950.200	2573.340	1376.860	34.9	65.1
1991-92	4194.980	2589.440	1605.540	38.3	61.7
1992-93	3276.450	2965.810	310.640	9.5	90.5
Total	17271.300	11658.910	5612.390	32.5	67.5

Source : Statistics Department, ADBP, Islamabad.

(US\$ = Rs 31).

In fact, financial distress has always been a feature of the financial scene but most of the time it has been associated with sectoral problems such as those affecting agriculture and industry. This has resulted in an excessive concentration of credit because of injudicious operations facilitated by inadequate and insufficient supervision. The World Bank has further categorised the reasons namely: (a) the failure of farmers to use borrowed funds for production; (b) the failure of the investment; and (c) refusal to pay. The following major reasons for the low recovery as studied are: (i) Absence of linkages and supportive services; (ii) selected asset items are not evenly supplied resulting in the manufacturing of substandard assets at inflated prices; (iii) unexpected household (consumption) expenditure for which funds are diverted; (iv) wrong selection of schemes not suitable for the area/borrowers; (v) assistance provided on piecemeal basis during natural calamities; (vi) sanctioning loans less than the scale of finance/unit cost or with a shorter repayment period; (vii) the attraction of subsidy in Government Supervised Schemes resulted in secondary importance to economic significance of the scheme; (viii) inadequate supervision and follow up by bank staff; (ix) Government apathy towards repayment; (x) complicated cumbersome and time-consuming legal process; and (xi) written-off loans by Government.

Thus the problems involved in the recovery of loans have not merely quantitative or organisational aspects but also involve qualitative and human aspects which need serious consideration if the issue is to be resolved.

### ITS POSSIBLE SOLUTION

Delinquency, in fact, denotes the failure to pay in time, and inability and unwillingness arise as credit rationing becomes increasingly intensive or extensive. Regardless of the definition of delinquency preferred, an understanding of the causes for this delinquency is essential if the delinquency rate is to be reduced. As per information gathered from the field by having contact with the borrowers the inventory of credit offered evidence which could show that 37 percent of the cases of delinquency were the fault of the borrowers whereas 37 percent were the fault of lending institutions and 26 percent were the fault of nature. The 37 percent of the delinquency cases which could be attributed to borrowers were broken down into: (a) Borrowers who had an attitude of indifference and of feeling no obligation to repay their loans (19 percent); and (b) borrowers who were able but unwilling to liquidate their assets to need their loan repayment obligation (18 percent). They were asked to specify particular reasons for repaying their loans to the private money lenders before they would repay to various institutional sources. The result

deduced were: (a) It is necessary to repay loans from a private money lender in order to qualify for a new loan next year—(51 percent of respondents); (b) private money lenders are more severe in their loans collection procedures than the formal sources (12 percent); (c) delinquency of a loan from a private money lender brings disgrace to the family (11 percent); (d) there is no possibility of not repaying—one is obliged to repay the private money lender (9 percent); (e) repayment to formal sources can be delayed until the borrowers has the means to pay (9 percent); (f) loans taken from the private money lenders are secret and are repaid on time to prevent the money lenders from disclosing the secret (5 percent); (g) the private money lender is located nearer and therefore gets repaid before formal sources (3 percent).

Further the main general causes for not repaying dues in time as disclosed by the majority of the respondents were: (a) Repayment is the result of the investment made with the loans. If it is not, one is justified in delaying repayment; (b) repayment of dues to formal institutions is not necessary because: (i) The formal sources are linked to government which is formed of peoples own representatives as such they take it as right to avoid; (ii) the borrowers gave gifts to the officials in the form of transaction cost to get approval of their loans; (iii) delivery of loans is not made in time; (iv) instalment of loans are paid in time delaying production operation/of the enterprise; (v) loans advanced must be in package but is advanced for one element mainly; (vi) Credit Officers of the bank visit borrowers for recovery of dues without prior warning with no continuity of relations; (vii) Credit Officers who are sent to collect loans are different, from the persons who processed and approved the loan; (viii) economic analysis of a potential borrower is not made following standard procedure; (ix) delinquency caused by nature/as-sociated with health and family problems of the borrowers, bad weather and low crop yields are overlooked which need special attention.

As learnt from different categories of borrowers it was made obvious that the delinquency caused can be reduced through both prevention and care. Delinquency caused by the borrowers can be reduced through a more careful screening of loan applications to avoid giving loans to those people who are not expected to repay back, or by putting pressure on those capable of but unwilling to repay their loans. This pressure should come from reputed persons or from village groups as well as from the field officers using personal persuasion tactics or giving threat of confiscating property or items against which the loan is advanced. Moreover, a majority of the farming community constitutes of small farmers, the near landless and the landless poor who possess neither resources nor capital to invest for