Counting the Costs
Culture of Small-Holder Money Management and the Impact of Corruption on their Access to Agricultural Credit

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Abstract

This paper presents an analysis of problem of corruption in the Agricultural Development Bank of Pakistan (ADBP) [now renamed as Zirai Tarqiati Bank Limited – ZTBL] and how it has contributed to its failure in reaching-out to small-holders and effectively meet their credit needs. It is based on field data collected through both formal and informal interviews and group discussions in sub-division Garh Maharaja in District Jhang, Pakistan. It argues that the cost of corruption to get the supposedly subsidised credit from ADBP is substantial, and it explains the fact that small-holders have remained reluctant to make use of it. In fact, the small-holders find the local market options relatively less expensive and easier to access in the normal circumstances. The reason that small-holders have recently become more dependant on ADBP is that, due to natural calamities such as floods and crop diseases, their income levels have declined and continue to remain uncertain and, as a consequence, the local input dealers are either unable or unwilling due to defaults on their earlier lending to offer more loans. In this situation, the ADBP has operated as a near monopoly actor in the credit market, while its staff has made extensive use of official discretion to extract bribes. Small-holders continue to borrow both for inputs for the next crops and consumption smoothing in the hope that following crops would be good but such hopes have remained unrealised so far.

1. Introduction

The importance of agricultural credit for small-holders to bring about agricultural transformation is well-established. It is argued that small-holders are efficient in agricultural production but they are poor and, therefore, if left unassisted, they are likely to lose their production strength, which could lead to an even under-developed agriculture (Kolajo, 1993). It was partly in recognition of this that many developing countries set up agricultural development banks in 1950s and 1960s. Broadly, these banks had two-fold objectives: (1) to provide longer-term agricultural credit that the commercial banks were reluctant to offer, and (2) to cater to the credit needs of 'risky' clientele such as medium and small farmers. These banks were largely state-owned and had an exclusive focus on agriculture with a development (non-commercial) orientation. However, the experience of past several decades shows that these have failed in reaching out to small-holders and achieving sustainability (e.g. GEMINI, 1995).

The existing literature lists a range of causes for failure of agricultural development banks, including 'adverse selection'[1] (e.g. Stiglitz and Weiss, 1981; and Carter, 1988), 'focus on agriculture and exclusion of non-farm activities'[2] (e.g. Bourne and Graham, 1984), 'high transaction and monitoring costs'[3] (e.g. Chaves and Gonzalez-Vega, 1996), 'subsidised interest rates'[4] (e.g. Gonzalez-Vega, 1990; Von Pischke, 1991; Krahnen and Schmidt, 1994), 'politicisation'[5] (e.g. Poyo, Gonzalez-Vega and Aguilera, 1993), and 'lack of deposit mobilisation'[6] (e.g. Robinson, 1992).

Although these explanations implicitly indicate the prevalence of 'corrupt' practices, it is rarely that 'corruption' has been used as a separate perspective in the analysis. This is despite the fact that it is an endemic and a well-recognised problem in most developing countries, and it significantly contributes to the failure of public policies and institutions. In addition, these explanations are largely focused on why agricultural banks have failed to become financially sustainable or reach out to small-holders, but with relatively less emphasis on understanding the problems that

[1] Adverse selection refers to a situation where lenders cannot ascertain the truthfulness of the borrower in view of imperfect information and hence the risk of the activity to be financed. Both private and state-owned institutions confront this problem. In the case of private sector, this risk may be insured against by higher interest rates. State-owned banks, like most agricultural banks, had no such option as the interest rates were subsidised and fixed.

[2] It is argued that their focus on agriculture reduced opportunities for portfolio diversification.

[3] It is hard and expensive to deal in small amounts with a large number of small-holders as compared to large-holders involving bigger sums.

[4] Arguably, subsidised interest rates led to increased demand and thus credit rationing, which worked to the relative exclusion of small-holders.

[5] It refers to a situation in which politicians start influencing bank lending for patronage of their voters or cronies or when they waive interest rates to gain political mileage.

[6] Most of these banks failed to mobilise local deposits to recycle for credit disbursal purposes. As a result, these remained dependant on concessionary borrowings or grants from state / central banks or foreign donors.

small-holders encounter in obtaining credit - particularly in terms of how 'corruption' works to exclude or restrict their access to agricultural credit.

This paper looks into the problem of corruption in the Agricultural Development Bank in Pakistan (ADBP) and how it has contributed to its failure in benefiting the small-holders. Although a case can be made that corruption has been the single most important factor in the failure of ADBP to become sustainable, this paper analyses only the experiences of small-holders and how, among others things, corruption considerably raises the cost of credit for them. The paper focuses on the following questions: 1) what are the various forms of corrupt practices that small-holders have to face in the course of obtaining agricultural credit? (2) how much the corrupt practices add to the cost of agricultural credit? And (3) how do small-holders manage their money and how it impacts on their decisions to borrow from ADBP?

The paper argues that the cost of corruption for small-holders to access the supposedly subsidised ADBP credit is substantial and this is an important reason why they generally prefer to stay away from it, since it is not necessarily considered cheaper as compared to market-based options. They approach the ADBP only when the market-based options to meet their specific credit needs either do not exist, or if these are denied to them for one reason or the other. An increasing number of small-holders have received credit from ADBP since mid 1990s but it is largely because of natural calamities like floods and pest attacks that hit them in the last decade or so, and constrained their access to market-based options. In such situations, the ADBP tends to operate as a near monopoly lender, that allows its staff to increasingly indulge in corrupt practices, particularly when official discretion is significant and culture of accountability lacking.

In addition to using secondary literature on agricultural credit, this paper is based on primary data collected from a sub-division Garh Maharaja, District Jhang in Punjab, Pakistan. The methods used included informal discussions, group discussions and semi-structured interviews involving small-holders, dealers in agricultural inputs, bank staff and representatives of various companies and input dealers outside the bank office. Some discussions also included medium and large farmers and were useful in term of developing a broader understanding of the related issues. Section 3 and 4 are largely based on insights and data thus collected.

The paper is divided in five sections. The second section gives a brief background on the agricultural credit market in Pakistan, with particular emphasis on the ADBP. The third section presents data from the field on various forms of corruption that small-holders have to incur in the process of accessing ADBP credit. The fourth section explains how small-holders manage their money and why their share in the ADBP credit disbursal has remained low despite that it is supposedly subsidised. The last section presents some of the key conclusions of the study.

2. Agricultural Credit in Pakistan

The rural credit market in Pakistan consists of a range of formal, semi-formal and informal lenders that include the ADBP, the Federal Bank for Co-operatives, Commercial Banks, Non-Governmental Organisations (NGOs), friends, relatives and dealers in agricultural inputs. The share of traditional money-lenders is almost negligible as the explicit interest-based transactions by individuals are not considered socially and religiously acceptable. Formal credit accounts for only one-third of the rural credit (Qureshi, Nabi and Faruqee, 1996), while the remaining two-third is explained by the informal sources. The ADBP is the dominant source of formal agricultural credit, as the share of Co-operative Bank and commercial bank remains very low. In 1985, the ADBP accounted for 55% of the total formal loans, as against 29% by commercial banks and 15% by co-operatives. Later in 1995, the ADBP provided 86% of total formal loans, followed by government (5%), NGOs (4%), commercial banks (3%) and co-operatives (3%). In the meanwhile, the share of friends and relatives, who generally do not charge any interest, went down from 67% in 1985 to 57% in 1995 (Khandker and Faruqee, 2001: 5). As the amount disbursed by ADBP has significantly increased since 1995, it may be that its share might have gone up further – considering that commercial banks remain reluctant to lend in the rural areas in view of their recent efficiency-driven restructuring under IMF / World Bank conditions.

The ADBP is supposed to provide subsidised credit to farmers. The sources of its subsidy include interest free grants and concessionary funds that it receives from the State Bank of Pakistan (SBP) and donor institutions like World Bank (WB), Asian Development Bank (ADB) and International Fund for Agricultural Development (IFAD). A number of studies have found ADBP as highly subsidised (e.g. PIDE, 1998). It is estimated that the net subsidy for ADBP had increased from Rs. 1,685 million in 1991 to Rs. 3,312 million in 1995 (Qureshi, Nabi and Faruqee, 1999). It is through these subsidies that ADBP has been meeting the costs of low interest and recovery rates.

For instance, the nominal interest rate of ADBP rose from 12.5 percent in 1991 to only 13.5 percent in 1995. As the rate of inflation during this period was in the range of 9.6 to 13.9 percent, it is obvious that the real rate of interest on an ADBP loan was negative for most of the time (Khandker and Faruqee, 2001: 14). If the cost of subsidies was to be discounted, "using the nominal rate for those years, it means, the nominal rate should have increased from 12.5 percent to 17.2 percent in 1991 and from 13.5 percent to 21 percent in 1995" (Khandker and Faruqee, 2001: 14). However, later in this paper, it would be argued that, although official interest rates in this period remained low, the cost of credit for small-holders was substantially higher in view of corruption costs.

Khandker and Faruqee (2001: 4) argue that "the effect of ADBP finance is substantial, and that the impact is higher for small holders than for medium and large holders in agriculture". They also argue that the ADBP is not cost effective and that it can be "made cost effective by supporting small-holders more than medium and large holders, improving both loan recovery and administrative

efficiency, and making operations liable to a lending portfolio". Similarly, Qureshi and others (1996) have underlined the need of more credit for small-holders and increased efficiency in the financial institutions through credit markets liberalisation. However, these and other similar studies largely focus on the supply-side of agricultural credit through ADBP which offered loans on subsidised rates, involved higher transaction costs, suffered from low recovery rates and thus failed to achieve financial sustainability. Therefore, the policy-recommendations that have followed aimed at making the ADBP financially sustainable through its restructuring as well as credit market liberalisation.

These analyses, however, implicitly assume that the problem of corruption is due to state-regulations, especially involving low interest rates, which lead to credit-rationing and hence opportunities for bank officials to collude with the powerful interests to the exclusion of disadvantaged such as small-holders. This assumption, however, seem not to be valid in view of the fact that credit demand is not necessarily always high in relation to the funds available to the ADBP. Firstly, the supply of credit has increased considerably over the years as it went up from Rs. 89.9 billion in 1994 to Rs. 39 billion in 2001 (ADBP Website; Dawn, 19 Dec. 2002), but the cost of corruption, instead of going down, has also witnessed a simultaneous increase (as it is shown in the following section). Now is it is because demand for credit has increased with an even faster pace? It may be true to some extent but it is important to underline that, on several times during the last decade, the ADBP failed to meet its yearly targets of credit disbursal; which suggests that demand might have been less than the amount of money available for credit disbursal. In 1999-2000, for instance, the overall disbursement witnessed some fall, which the ADBP attributed to 'better liquidity position with farmers'. Similarly, in 2001-02, the ADBP could achieve only 83% of the total target disbursements (ADBP Website).

It is also important to understand the existing agricultural credit markets and what role the ADBP currently plays for smallholders in it. As it would be explained in the following sections, the ADBP so far has worked as the lender of last resort from the perspective of small-holders. In other words, when small-holders cannot access credit from the market sources, they approach the ADBP – something that they would not do in the normal circumstances in view of the higher corruption costs. If this be the case, small-holders' dependence would remain on the ADBP in such emergency situations. Therefore, if the idea is to make ADBP work for the benefit of small-holders, both in normal and emergency situations, it would be pertinent to take measures to reduce take measures aimed at reducing corruption costs for them. So far, it is not realised that market liberalisation, involving higher interest rates, would only constrain small-holders' options, as it is not clear at all that it would automatically result in simultaneously reduced corruption costs for small-holders.

3. Counting the Cost of Corruption

Corruption is endemic in the ADBP and plays a crucial role in restricting small-holders access to its services. The form of corruption that small-holders most

commonly experience is 'bribery'. According to Amundsen (2001: 1), bribery refers to the "payment (in money or kind) that is given or taken in a corrupt relationship", while its equivalent terms include kickbacks, gratitudes, baksheesh, sweeteners, pay-offs, speed or grease money. It is a "a fixed sum, a certain percentage of a contract, or any other favour in money or kind, usually paid to a state official who can make contracts on behalf of the state or otherwise distribute benefits to companies or individuals, businessmen and clients" (Amundsen, 2001: 1).

In the absence of an established culture of accountability, the Bank officials are often motivated by considerations of personal gain through the use of public office. They collude with the politically influential individuals and families, who they believe could be helpful in protecting them against any complaints and exercise their influence in their transfers, postings and promotions. These often include local members of provincial and national assemblies, senators and others who are politically active and are considered influential. In return, these local influential individuals benefit through privileged treatment and a range of undue benefits offered by the Bank. For instance, their loan applications are processed expeditiously and irregularities on their part, including previous defaults and misuse of funds, are invariably ignored. Sometimes they get credit while pending documentary requirements.

For small-holders, it is almost invariably an arduous task to access ADBP credit, despite a number of policy initiatives aimed at increasing the out-reach of the Bank to small-holders. The bank officials, among others, deliberately work to fail such policies, as their implementation would undermine their ability to make favours against bribes. In 1997, the Nawaz Sharif government started the 'One-Window Operation' scheme to reduce the transaction costs of small-holders. It required all the relevant officials to sit at one place so that farmers needed not to travel to different places to meet documentary requirements. In practice, however, it failed to make any significant difference, as the most substantial costs were basically corruption-related. Small-holders, who were unable or reluctant to pay bribes, continued to suffer from delays and denials of credit on one pretext or the other.

In 1979, the Bank had introduced the Supervised Agricultural Credit System (SACS). Under this, Mobile Credit Officers (MCOs) were appointed to visit farmers, assess their needs, do the relevant documentary work for them for credit, and later supervise that the credit obtained is used for the sanctioned purposes. Again the purpose was to reduce small-holders' transaction costs. However, the MCOs rarely go out, except for recovery purposes, and prefer to operate from the office. While the ADBP continues to take credit for this system in its reports and publications, it is not functional in reality, and small-holders in the area have to frequently travel, sometimes significant distances, to reach the Bank. Many believe that it happens for the simple reason that if MCOs proactively approach small-holders in the field, they will not get bribes as they would be seen as too keen to offer credit. They need to create a sense of personal importance and scarcity of loan-able funds in the Bank. In addition, it may be attributed to the fact that the Bank lacks a

system of internal accountability, and the remuneration and benefits it offers to its staff are not linked with performance.

Just the application process involves a number of steps, including purchase of pass book from the Post Office, assessment of landed property by the *Patwari* (revenue officer) and obtaining of application forms. At all these steps, small-holders have to pay bribes, often amounting to several times of the actual cost. For instance, the price of pass-book is often between Rs. 100-Rs. 150 as against its official price of Rs. 20. Same holds for the loan application forms that are made available on much higher cost than the official price. Although these are small amounts paid at various steps, when added up, these constitute a significant percentage of small-holders' loans.

More substantial amounts are paid as bribes to the Bank officials who process the loan applications and sanction loans. The Bank officials adopt rude attitudes towards small-holders and do not entertain their applications, sometimes on the pretext that funds are not available or that they should come again while pointing to the need of more documents. Small-holders, who have to work in their farms, find it extremely difficult and annoying to visit the Bank again and again even after having done all the documentation required. The point to be made here is that even the small-holders, who themselves approach the Bank after having done the required documentation, do not get loans unless they pay bribes – not to speak of Bank reaching out to the small-holders through MCOs.

Corruption is a system in the Bank. Almost all customers take it for granted that they will have to pay at least 10% of the loan requested as bribe. For instance, in the case of loans for tractors, an amount ranging between Rs. 25,000 and Rs. 50,000, depending on the value of the requested tractor (e.g. Rs. 25,000 for Messy 240 and Rs. 50,000 for Messy 375), is charged as a bribe. Apparently, the cost of bribe for tractor loans seems to have monumentally increased over the past 5 years. Earlier, it used to be about 5% of the total value but now it is around 10%. It must be pointed out that %ages and amounts mentioned here are charged even if the application for credit is legally valid, and the applicant is not asking for any special favour.

There are situations where applicants request special favours and, as a result, have to pay higher amounts in bribes. If an applicant does not have enough cash to pay for 10% or more up-front contribution or advance for a tractor, the Bank officials find a way to circumvent the rules, for instance, by sanctioning another loan for the applicant for agricultural inputs or implements. This enables applicants to use the loan thus received to pay required up-front contribution for the tractor. In other words, the loan thus granted is not used to buy inputs or implements, but to pay contribution for the tractor.

In situations where a farmer is unable to repay his earlier loans, the Bank officials operate as individual money lenders and offer him credit from their own pockets on about 10% interest rate to repay his loan. (It my be noted that this 10% is not on per yearly basis but just for a few days and hence is extremely expensive). Once the outstanding amount has been cleared through this private credit, the Bank officials prepare another case in his name, sanction a higher amount, deduct their private credit along-with the 10% interest rate, and return the outstanding amount, if any, to the customer.[7] This informal system has its own safeguards, guaranteeing that private credit extended by Bank officials is repaid. These are clear examples of 'adverse selection' but basically because of personal gain considerations and not as a result of 'imperfect information'.

Even after a case has been sanctioned, farmers have to pay bribes at a range of different steps. For instance, the cashier gets bribes at the point of issuing cash or cheque and, it may be that later, the Bank would not totally reimburse the farmers the amount that they might have deposited in the Bank for one or the other legal or procedural requirement. Similarly, the Bank staff charges bribes in the process of recovery by informally allowing farmers more time, which, on the one hand, damages Bank's recovery campaigns and, on the other, leads to the charge of increased interest rate on the defaulted amount as per rules -- while farmers may not be aware of it. It is believed that Bank officials pay a fixed share of bribe money to the higher officials, and in some cases, to politically powerful individuals in the area. Perhaps this explains that the Bank officials have been continuing with massive corruption, extortion and inappropriate banking practices without any fear of scrutiny or accountability.

There operate a number of brokers, agents and representatives of various tractor companies, and dealers in pesticides, fertilisers and seeds outside the Bank. Most of them work as intermediaries between the Bank officials and customers; and it is through them that some of the customers pay bribes. These agents etc. too pay bribes to the Bank officials on monthly basis. They do it in order to have privileged and uninterrupted access into the Bank premises to market for their respective products --- sometimes employing Bank officials to do their bidding. On the positive side, these dealers facilitate customers by providing them on-the-spot quotations etc., as required for documentation purposes.

It was widely reported that the loans obtained from the Bank are in many cases used for non-agricultural, and even non-productive, purposes.[8] According to a rough estimate, about 50% tractors financed by the Bank are immediately sold to raise money for other purposes. This is, however, almost impossible without the complicity of the Bank staff. Given that the credit for tractor was already expensive, if the costs of bribes were to be included, and now the tractor is sold on a depreciated market price, the land-owners or farmers end up losing huge sums on their loans from ADBP. In most situations, farmers do this to meet some emergency or consumption needs; and do not necessary understand the full implications due to lack of information.

[7] This is how Bank has been able to show satisfactory statistics in terms of recovery rates in its past annual reports. For instance, the ADBP's Annual Report 2000 claimed a 'record recovery' of RS 30,129. However, if contrasted against the actual field practice of how past loans are recovered and new ones are made, such claims become deceptive and misleading. It appears that the Bank does not have any system of receiving this kind of feedback from the field. The annual reports are full of statistics, excluding any discussion on field practices, common complaints by farmers, and the measures that the Bank might be proposing to deal with such complaints.

[8] Article 23 (Ch. IV) of the Agricultural Development Bank Ordinance, 1961 says that the "Bank shall require and, as far as possible, ensure that a loan is spent on the purpose for which it is made…". However, it seems that the Bank has almost totally failed on this count.

It is hard to calculate exactly the total costs of corruption as these include percentages of total amount requested as well as fixed amounts on certain steps irrespective of how much a small-holder would like to borrow. But it can be roughly estimated at about 13% (including the fixed charges for passbook, application forms and assessment by Patwari, and then at least 10% of the total amount that is charged by the Bank officials). It becomes even more expensive if small-holders have defaulted on previous loans and they have to pay bribes to avoid detention; or if they would need to borrow more to repay the earlier loans as well as for more consumption needs.

4. Costs of ADBP Credit and Small-holders Money Management

It is a recognised fact that small-holders access to credit-schemes is often limited, particularly in relation to the agricultural development banks. As for the ADBP, the share of small loans (up to Rs. 25,000) was 33.3% (124638) in the total loans disbursed (374243) in 1999-2000. In terms of amount disbursed, it was even less as it accounted for only Rs. 2.05 billions out of the total amount of Rs. 24.4 billions (see the Table 1). This obviously means that, firstly, a very small number of small-holders get ADBP credit and, secondly, they account for a very small %age of total amount disbursed. The question arises why small-holders have not been successful in making use of ADBP credit?

Table 1

Agricultural Credit Disbursed by size of Loan (1999-2000)

Rs. In Million

SIZE OF LOAN	No. of Loan Cases	SHARE (%)	Amount Disbursed	SHARE (%)
UPTO Rs. 25,000/-	124638	33.3	2052.798	8.4
Rs.25,001 TO 50,000/-	134146	35.9	5447.959	22.3
Rs. 50,001 TO 100,000/-	55057	14.7	4275.275	17.5
Rs. 100,001 TO 200,000/-	33419	8.9	5034.157	20.6
Rs. 200,001 TO 500,000/-	26846	7.2	7528.203	30.8
Rs. 500,001 TO 1,000,000/-	136	0.0	84.397	0.4
ABOVE Rs. 1,000,000/-	1	0.0	1.100	0.0
TOTAL	374243	100.0	24423.889	100.0

Source: ADBP Website

Most of the existing literature argues that it is because lending institutions find the **transaction costs of dealing with small-holders higher and, therefore, prefer not to deal with them. Or because there is a high demand for subsidised credit, which leads to credit rationing wherein small-holders lose out (e.g. GEMINI, 1995; Chavas and Gonzalez-Vega, 1996). But here, the case in point is ADBP that claims to prefer small-holders and takes pride in having MCOs to reach out to small-holders at their**

farms. It has 162 branches just in Punjab (the province in which the Garh More ADBP branch studied here is located) that makes an average of over 5 branches per district. The total strength of ADBP in the year 2000 was 7782, including 4586 officers and 3196 staff (ADBP Website). At the national level, this makes an average of over 22 persons per branch. The ADBP branch under study here has over 20 people staff, including 2 credit officers (Cos) and 4 MCOs. In view of this huge infrastructure, it cannot be assumed that small-holders find it difficult to reach the ADBP branches; or that ADBP would need any substantial additional costs to reach out to small-holders and process their cases. Instead, it is corruption that explains this failure better, as it is widely believed that it "protects and rewards inefficiency and undermines accountability, in both business and government process, while short-circuiting honest economic competition" (Johnston, 1999: 90).

It is, therefore, argued that although the agricultural credit is subsidised from supply-side perspective, the substantial additional cost of corruption makes it more expensive than the market options. The small-holders find it relatively easier and cheaper to depend on alternative options for credit such as relatives and friends, who generally do not charge interest, and dealers in agricultural inputs, who are not only easily accessible but also provide cheaper credit. In addition to other factors, this significantly explains why their share in the over-all ADBP credit disbursal remains small. In the corruption-ridden ADBP, the demand for credit by small-holders is likely to remain low in normal circumstances.

Irfan et al (1999) have cited the average annual mark-up on inputs in Pakistan between 18% (on the basis of a survey data) and 25% (on the basis of case studies) – including 35.2% on pesticides. These estimates, however, should be taken cautiously in view of a number of survey data constraints as recognised by Irfan et al themselves, but particularly in that these might vary across regions. The data collected for this study suggests, for instance, that the mark-up for pesticides may not be as high as 35% because the market has developed considerably over the last several years, involving a multitude of companies and dealers, and there exists significant competition. In addition, it also varies across individual farmers as they are often well-informed about market prices, particularly the difference between the price of inputs available on cash vis-à-vis on credit, and they often make individual bargains and hence settle for prices on case by case basis – often lower than the figures given by dealers on the first asking.

Table 2: Average Annual Mark-up (Interest) by Inputs

Inputs	Mark-up
Fertiliser	18.6 (29.0)
Pesticides	35.2
Seeds	7.8
Other inputs	8.0
All inputs	18.0 (25.0)

Note: Numbers in parentheses indicate mark-up calculated on the basis of case studies data.
Source: 1996 Survey of Informal Lenders (as cited in Irfan et al, 1999: 19).

But even if the aggregate interest rate in the market is 18%, it makes it cheaper as compared to the ADBP loans. As the official interest rate in the ADBP has remained

around 13%, it is cheaper compared to the market credit only by 5% and, considering that small-holders often need small amounts, they prefer to opt for market options in view of their easy and timely access. What further deters them from approaching ADBP is that its credit is actually much more expensive than it appears at the first instance by statistics shown in existing research and official documents. As discussed in the earlier section, corruption leads to at least doubling the cost of it – and hence making it almost totally unattractive for small-holders. But why then small-holders approach the ADBP for credit when they do? The following paragraphs argue that they do not want ADBP credit in normal circumstances but they have to opt for it in situations of perceived emergency or where market-based options do not cater to their specific needs.

Until early 1990s, the small-holders approaching the ADBP for credit included those who needed to buy tractor for commercial use. The cost of tractor was very high and was hard to afford through personal savings, while there existed no market-based mechanisms to extend tractors on credit or credit to buy tractors. In this situation, the relatively progressive small-holders who thought that they could make a productive use of a tractor to efficiently cultivate their own farm as well as to lend tractor-related services to neighbouring farms on commercial basis would find ADBP relevant. These farmers would often exhibit entrepreneurship, make profitable use of the commercial possibilities, and repay their loans in time. Although they had to pay bribes, but they had no other options and, in any case, they thought that the benefits out-weighed the costs as the tractor was to be largely used for commercial purposes.

A second group of small-holders who would approach ADBP included those with pressing emergency needs such as disease in the family, need to repair or build house, marriage of a daughter, setting up a small-business for a son, or purchase of more land. In such cases, the first option available to the small-holders is to mobilise their personal savings (selling jewellery or cattle) and then request relatives and friends for help. However, if they were still short of money, and they felt that the need was pressing, they would contact the ADBP or any other lending bank as a last resort. In none of these cases, the immediate objective was to improve crop productivity but to meet an emergency need.

The number of small-holders applying for ADBP credit significantly increased after certain natural calamities that adversely impacted their personal savings and constrained their ability to market-based credit options. These calamities included the heavy floods in 1992 and 1996, and the massive pest attack (curl-leaf virus) on the cotton crop in mid-1990s. As most of the small-holders lost their cotton crop, which is the only major source of earning them cash, they failed to repay to input dealers. This constrained both the capacity and willingness of input dealers to make further lending to the small-holders. In this situation, friends and relatives too could not help much, as most of them were themselves affected by the natural calamities.

Small-holders, who desperately needed credit for inputs for the following crops or consumption-smoothing, had to seek credit from ADBP --- something that many of them might not have resorted to in the normal circumstances. This situation allowed ADBP to become a near monopoly actor in the credit market – hence greater opportunities for corruption. It has been argued that "[c]orruption equals *monopoly* plus *discretion*, minus *accountability*" (Klitgaard, 1988: 75; emphasis original) – and here was a situation involving significant monopoly in emergency situations and a great deal of official discretion, while the culture of accountability, like many institutions in the developing countries, was lacking.

Thus the ADBP credit was, on the one hand, expensive in view of significant corruption costs and, on the other, it was obtained in the emergency circumstances wherein a higher proportion of it (higher than what it would be in the normal situations) was used for consumption smoothing purposes. Expectations that earnings through the following years good crops would help repay the loans thus obtained did not materialise in view of a variety of factors including further natural calamities[9], declining yields[10], increasing cost of inputs as a result of reduced subsidies[11] and volatility in market prices of agricultural commodities.[12] This partly explains the low recovery rate by the Bank and a default or a near default situation by a significant number of small-holders. Given that the small-holders had a very weak financial position, they had to depend on further borrowings to repay earlier loans and for continued consumption smoothing – involving even higher corruption costs as explained above. Small-holders are often credited for better repayment record of agricultural loans (e.g. Khan, 1994) but it needs to be understood that in some situations they have to repay under threat of arrest and detention by the Bank officials that often results in even more expensive borrowings or sale of property on their part.

5. Conclusions

First conclusion of this paper is that although agricultural credit is officially subsidised, it turns out to be very expensive for small-holders as a result of substantial costs of corruption that they have to pay at a number of steps in the process of obtaining credit. The real costs of ADBP credit could be as high as over 26% -- almost double the percentage of official interest rate.

Secondly, corruption has played a significant role in the failure of a number of policy initiatives that were aimed at increasing the reach-out of the Bank to small-holders and reducing small-holders transaction costs. One example of such failures is the so-called Supervised Agricultural Credit System (SACS) that provided for Mobile Credit Officers (MCOs) to reach-out to farmers and provide them loans to meet their needs. Apart from

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[9] These included floods, pest attacks and drought conditions (Government of Pakistan, 2001).
[10] For instance, cotton yields declined after the peak year of 1991-92, partly because of frequent attacks by pests that had developed resistance as a result of extensive use of pesticides over the last several years (e. g. Banuri, 1998).
[11] For detailed discussion, see Zaidi, 1999.
[12] See Zaidi, 1999.

other reasons, MCOs create an artificial sense of scarcity of funds and stay in their offices – because if they go out, they might be seen as too keen to offer credit and it would not help them in extracting bribes.

Thirdly, since the agricultural credit offered by ADBP is expensive in view of corruption costs, small-holders generally prefer not to opt for it. In normal circumstances, they find the market-based options of agricultural credit (e.g. input dealers) relatively cheaper and easier to access. It is because the local input markets include a multitude of actors, which allows small-holders to bargain and get better deals – often involving costs that vary from individual to individual.

Fourthly, small-holders apply for ADBP credit for needs for which market-based options do not exist or are not accessible to them for some reasons. One example of this is buying of a tractor, which some small-holders might want to buy for commercial usage, but it requires lending of significant amount and for a longer duration. Additionally, there may be consumption needs, which are not met by the market, and small-holders opt to apply for ADBP loan. As such loans are not allowed under the Bank's rules, significant amounts are paid in bribes to the Bank officials to obtain these.

Finally, in recent years, a large number of small-holders have become ADBP's clients. It is because a series of natural calamities in 1990s constrained their market-based options, as input dealers were less able or willing to make loans. In such situations of wide-scale emergencies, the Bank has operated as a near monopoly lending actor, which allowed its staff to make use of official discretion and extract even higher percentages in bribes. An overall culture of lack of accountability has helped to continue these corrupt practices continue unabated.

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