

Institutional Change Exhibited by Agricultural Credit System :The Case of Northwest Pakistan

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This paper analyzes the process of institutional change as a consequence of changes in agricultural credit system in six selected villages of Northwest Pakistan over a period of four decades. The findings reveal that the presence of social organizations and institutions in the area strongly influence socio-economic life of the people. However, with the outer orientation and effects of modernization, changes have occurred in the traditional 'production and exchange' relations among the people. Consequently, business oriented agricultural credit institutions have incurred changes to adjust to the newly emerged situation. The structure of formal credit institutions as well as credit relations and procurement processes has become commercialized in the recent past. Nevertheless, the personalized relations among different stakeholders still dominate these commercialized market relations. Thus, the traditional credit institutions continue to exist parallel to the commercial credit institutions to supplement their functioning in the area.

Field of Research: Economic Development and Policy

1. Introduction

The behaviour patterns and relations of people within the traditional village system are characterized and controlled by moral principles and customs (Hayami & Kikuchi, 1981). On one hand, the resulting behaviour patterns and rules are controlled by being internalized and, on the other; the fellows control each other through their personal acquaintances. The socio-economic life of rural population remained relatively undisturbed and balanced in past. The interaction of people within social, political, and economic sectors was characterized by a multi-stranded, personalized network of relations (Inayat, 2007). The traditional village system and its institutional structure in the Pathan¹ society

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¹The Pathan is an ethno-linguistic group predominantly living in Northwest Pakistan, speaking Pashto as their mother tongue. Their socio-cultural and economic life is confined in the moral code of honour called '*Pukhtoonwali*'.

of Northwest Pakistan also remained in equilibrium. However, the population pressure and technological change with time led to permanent pressure to change the regulating institutions and the creation of new regulative institutions (Hayami & Ruttan, 1985). Thereby, changes were necessitated in the social production, distribution, and exchange systems as well as other institutions. Consequently organizations associated with rural production and exchange system changed their modes of services to the beneficiaries.

During 1967-68, some faculty members of the Institute of Rural Development, University of Goettingen, Germany conducted an empirical field study of selected institutions with the aim to analyze the societal change process in six villages of district Peshawar in North West Frontier Province (NWFP) of Pakistan. The selection of the villages was based on some socio-economic and logistical criteria such as:

- The influence of economic and administrative centre Peshawar,
- Land Tenure System,
- Type of Irrigation System,
- Occupational Structure (Inayat, 2007:5; Manig,1991:19)

The study was followed-up in 1986-87 and then 2005-06 and changes in the selected institutions were analyzed over four decades (Inayat, 2007).

Problem Statement and Justification

Pakistan has a large rural sector that is primarily based on agriculture and other related activities. Despite being such an important sector of the economy, production per unit area is quite low. The reasons for this low productivity, among others, are capital shortage to the farmers and intuitional traditionalism. A smooth agricultural and rural development process requires equilibrium between the development in agriculture and other rural activities and that of institutions existing in rural areas. A considerable change has taken place over the last decades in agricultural based rural life in Pakistan. To cope with the changing situation, the institutions and organizations providing agricultural credit services have adjusted their structures in order to achieve desirable results. This paper addresses the following general questions:

1. To what extent changes have occurred in the agricultural credit systems in the area?
2. What is the influence of changes in credit systems on institutional change in the area?

Through this paper, efforts have been made to find logical explanations to answers these questions so that to ascertain changes in institutions in the course of time in the region. These questions were the main determinants for the direction of this study.

Research Objectives and Hypotheses

The aim of the study was to identify changes in agricultural credit systems and its consequences on the institutional changes in the area. The specific objectives of the study were as follow:

1. To identify changes that have occurred in the credit systems in the area,
2. To study the impact of these changes on institutional changes in the region.

The study was based on the following main hypotheses.

1. Agricultural credit systems in the area has incurred changes over time,
2. Changes in the agricultural credit systems have influenced institutional changes in the area.

2. Literature Review

Social changes are induced by a multitude of exogenous and endogenous influencing factors. As an immanent component of the societal development processes, therefore, institutions also undergo change (Manig, 1992). A central concern of the development economics is the analysis of changing economic and social institutions. The study of change requires observation of individuals and communities at different time intervals.

Changes in institutions imply adjustment of the old as well as establishment of the new institutions. On one hand, this adaption occurs as a result of independent and subconscious step by step changes in existing institutions and on the other hand, the interventions of the state and other stakeholders to create new institutions as part of the development policy (Manig, 1992).

Agriculture is an important component of rural life in Pakistan and changes in the agricultural system guide changes in rural livelihood structures. Agricultural credit institutions support farmers to sponsor technology and inputs. Changes in these institutions cause direct changes in the production, exchange, and distribution systems, which further change the social, economic, and political systems in the area. To identify such changes, it is necessary to analyze all the concerned institutions at different intervals of time.

Theoretical Framework

The study of institutions as a sub-discipline of economics dates back to the early 20th century. The original 'institutionalists' assumed approaches of investigation and writing that were descriptive, anti-formalist, holist, behaviourist, and fairly interventionist (Kay, 1997). The old institutionalists mostly employed case study methodologies with little analytical rigor and no theoretical framework. The 'Old Institutionalism' ultimately failed to develop as a school of thought, perhaps due to failure to develop a research strategy with clear direction and methodology (Williamson, 1993).

In 1960s, a new approach to study of institutions emerged known as 'New Institutional Economics' (NIE). The contributors used research methodologies derived from neoclassical economics but gave particular attention to transaction costs (Challen, 2000). Like its older counterpart, NIE is interested in social, economic, and political institutions that govern everyday life. However, NIE eschews the holism of the older school and follows strict methodological individualism (Klein, 1999).

NIE builds upon the idea that institutions and organizations seek to achieve efficiency, maximizing profit, and minimizing comprehensive cost (production and transaction costs). Business firms having flexibility to adjust to the emerging issues do best and grow, while those with poor organization incur high costs and decline. In the uncertain and non-stationary environment of the real world, a firm with its given organizational structure may do well and then suddenly meet new conditions to which it is poorly placed to adapt. Nevertheless, the existence of selection mechanism enables firms to adjust to the newly emerging disciplines to increase performance and output (Dixit, 1996).

Institutional Change Process

Institutions are the infrastructures that are set up to arrange human interaction and to facilitate social networks and economic exchange to run satisfactorily (Marshall, 1994). Institutions come into existence in two ways; they may be deliberately created, or they simply evolve over time via changes, adaptation, and adjustment to changing circumstances and growing social needs. However, changes at the edge of institutions may occur so slowly and smoothly that one needs to stand back as a historian to perceive such alteration (North, 1990).

Institutional change is a continuous transformation process in societies, which means change in the principles of regulation and organizations, behaviour and interaction patterns (Manig, 1991). The institutional change itself leads to change in the conditions, which then make new adjustments necessary (Manig, 1992). New institutionalists explain institutional change in two ways. First, institutions change in reaction to the new economic factors. Second, entrepreneurs

(organizations or individuals) exploit openings within the institutional system, resulting in innovative change (Hira & Hira, 2000).

Institutional Structure of Credit Systems in NWFP

Institutions, on one hand mean rules and behavioural norms that are prevailed in a society. On the other hand, institutions mean the organizations that adopt these societal rules to adjust their strategies. Two types of financial institutions – formal and informal, provided credit services to the farmers in NWFP. Formal financial institutions defined as Agricultural Development Banks, Commercial Banks, and Micro-Finance Institutions (MFIs) (Zeller & Sharma, 1998). The informal institutions included friends, relatives, neighbours, commission agents, professional moneylenders, and informal, indigenous institutions.

The sources of institutional credit in NWFP are Zarai Traqati Bank Limited (ZTBL), commercial banks, and credit cooperatives. In recent past, the supply of loans by formal creditors expanded. National Bank of Pakistan started a selective credit policy in 1972 and presently, almost 3000 branches of all commercial banks grant credit (Inayat, 2007). The supply of credit from commercialized creditors varies very little with respect to the upper credit limits and the security demanded.

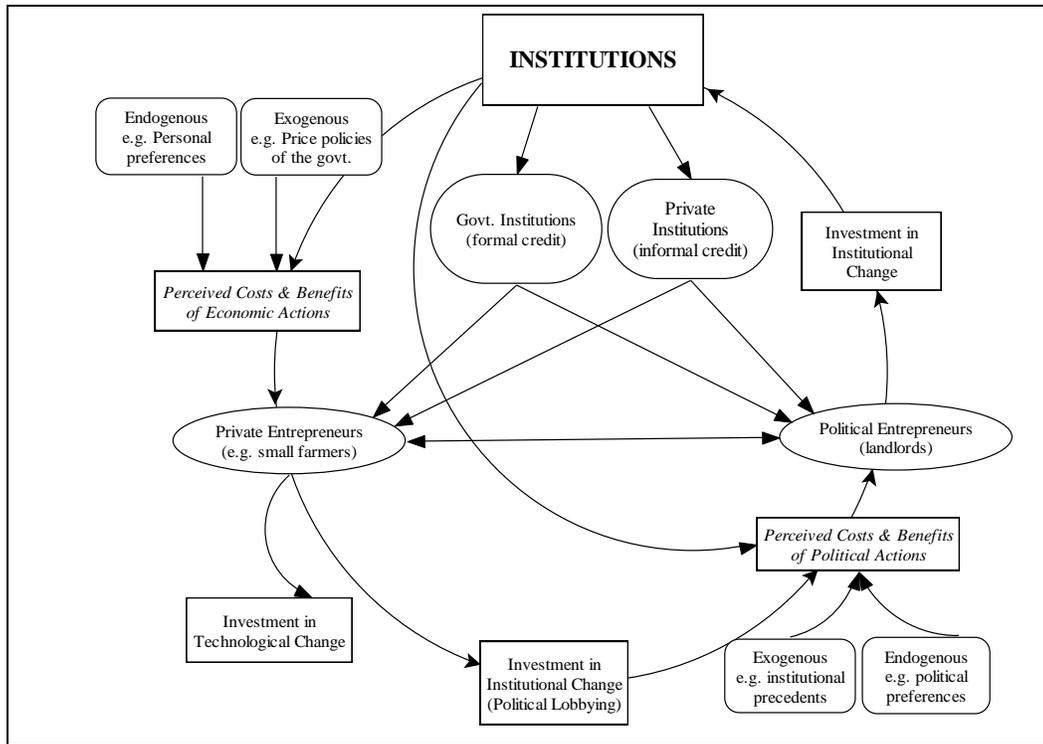
Though the supply of credit from the formal institutions has expanded, still less than 10% households have access to adequate and affordable financial services. They face severe constraints when they seek credit from formal institutions. Formal financial services are often not available to the poor, because of restrictions that loans be backed by collateral. In addition, more influential groups use their influences to derive more benefits from the credit programmes. Consequently, majority of credit worthy small farmers turn to other traditional financial markets. The informal credit sources play a significant role in eliminating and controlling the societal differences. Thus, the possibilities of expanding social polarization are reduced by the informal credit institutions in meeting the capital requirements of poor farmers (Manig, 1990).

Conceptual Framework

The model of institutional change shows change arising from the behaviour of various groups in the society. The model describes institutional change as a process of interaction between two entities; private entrepreneurs and political entrepreneurs. Private entrepreneurs include the agents which are subject to institutional change. This group includes small farmers, tenants and less influential strata. The political entrepreneurs, the influential agents with decision making power, include: landlords, socio-politically dominant groups and management of credit organizations. In this model, the demand for institutional change arises from either private or political entrepreneurs when either of these agents perceives a potential for net benefits from investment in institutional

change. Such changes in agricultural credit institutions in the research area were analyzed through this study.

Figure 1: The Conceptual Model of Institutional Change



Source: modified after (Inayat, 2007; Challen, 2000; North, 1990)

3. Methodology and Research Design

The research was conducted in 2005-06 in six villages of district Peshawar in Northwest Pakistan. The villages included Dalazak, Kukar, Gulbela, Kochian, Mushtarzai, and Yousafkhel. Since this was a semi-longitudinal study analyzing institutional change process over a period of time through a series of studies, the selection of villages was based from the previous studies. These villages represent different socio-economic, agro-ecological and infrastructural situation. Therefore, a variety of feedback was expected from the respondents in different villages.

The research method used for data collection was intensively interview based. A semi-structured questionnaire was used to collect both qualitative and quantitative data. The primary data was collected from the villages, whereas secondary data came from the business-oriented credit institutions. The data were analyzed by using SPSS and STATA.

4. Discussion of Findings

The term credit refers to the temporary transfer of purchasing power from one person to another for a limited period. Credit can be granted free of charge or for interest depending upon the system in which credit is granted. Like other rural systems, both formal and informal credit institutions were functional in the area. In this section, a comparison of the current credit situation in the area is being made with situation in past. It is worthwhile to mention that the data from 1967-68 were not available; hence, the reports of the study published in different monographs were used to derive some theoretical basis for comparison.

Volume and Distribution of credit

Table 1 provides a comparison of the current credit situation in the area with the past. The table shows that a considerable decrease has occurred in the distribution of credit in the region. Presently, 41% households in all villages attained credit compared to 60% in 1986-87. Similarly, the average credit sum procured in all villages was Rs. 47,700 compared to Rs. 11,926 per household during 1986-87.

The village wise comparison showed that Gulbela, Kochian, and Dalazak, which were highly involved in credit in past (both in proportion and in credit sum), were recently left behind. Presently, Kukar, Yousafkhel, and Mushtarzai were involved in higher credit procurement.

Table 1: Credit Situation in six Villages in Northwest Pakistan, 2005-06

Village	1986-87		2005-06	
	Households (%)	Credit Sum (in 1,000 Pak. Rs)	Households (%)	Credit Sum (in 1,000 Pak. Rs)
Kukar	52	12.4	43	80.0
Yousafkhel	41	14.3	39	53.8
Gulbela	67	13.8	42	29.2
Kochian	67	16.3	39	39.7
Dalazak	64	8.4	35	16.1
Mushtarzai	61	9.0	46	40.1
Total	60	11.9	41	47.7

Source: Field Data, 2005-06; Manig, 1991

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The decrease in the overall distribution of credit in the area was due to changes in the employment structures, cropping patterns, and marketing preferences of the farming communities. The changes in credit procurement occurred mainly in the proportion of small holders. It depicts that the personalized relations, where people dependencies on each other were high in the past, have changed with time.

Changes in the Credit Sources

It is clear from all studies that large proportion of credit procurement came from the informal credit institutions. In all villages, the informal credit sources contributed to 96% and almost the same percentage (95%) was recorded in the previous studies. Amongst the informal sources, friends and relatives were the most important sub-categories which constituted 77% of the total credit transactions.

Table 2: Credit Sources in Six Villages in Northwest Pakistan, 2005-06

Credit Source	Credit Sum in 100 Pak. Rs.						Total
	1 - 25	26 - 50	51 – 100	101 - 500	501 – 1000	over 1000	
Friends	1	2	5	19	4	2.8	34
Relatives	1.2	5.3	8	21.3	5	2	43
Private Acquaintances	0.4	1.5	2.4	5.3	3.5	4	17
Government Deptt. / office	0	0	0.2	0.7	0.3	0.1	1
Other informal sources	0	0.2	0.1	0.4	0	0	0.7
Sub-total	2.6	8.8	15.7	46.7	12.8	8.9	96
Banks	0.1	0	0.2	2	0.7	1	4
Sub-total	0.1	0	0.2	2	0.7	1	4
Total	3	9	16	49	13	10	100

Source: Field Data, 2005-06

The second most important source of credit was private acquaintances. In past, 27% of the credit came from this source which accounted for 17% in 2005-06. Like the previous studies, formal credit institutions shared only 4% to the total credit borrowing.

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Table 3: Credit Sources in Six Villages in Northwest Pakistan, 1986-87

Credit Source	Credit Sum in 100 Pak. Rs.						Total
	1 - 25	26 - 50	51 - 100	101 – 500	501 – 1000	over 1000	
Relatives / Friends	17	11	12	9	1	0	50
Private Acquaintances	8	7	5	6	1	0	27
Businessmen	1	0	1	2	0	0	4
Store Owners	5	1	1	0	-	-	7
Commission Agents	1	0	0	1	-	0	2
Employers	1	0	1	0	0	-	2
Other informal sources	1	1	1	0	0	-	3
Sub-total	34	20	21	18	2	0	95
Banks / Cooperatives	0	0	1	3	0	1	5
Sub-total	0	0	1	3	0	1	5
Total	34	20	22	21	2	1	100

Source: Manig, 1991

The informal credit transactions are based on social interaction among the people. This interaction, based on the principle of reciprocity, is stronger among relatives and friends. In emergencies, the kinship and friendship relations are the principal social capital that meets the needs of other fellow. This social capital is a strong element of the Pathan's life in the area. It shows that the multifunctional institutions of the Pathans traditional society are fully functional and have not lost their importance (Zuberi, 1983).

Changes in the Utilization of Credit

It has been observed that rural households often need credit to finance different on and off-farm activities. The findings of the study revealed that most demand for credit in the area was to finance off-farm activities like social festivals, consumption, medical treatment, and off-farm investment. By far, the frequent demand for credit was for financing social festivities.

Out of total, 23% borrowers used the amount for social festivals (weddings, death ceremonies etc.). The results from the previous studies represented the same picture (Manig, 1991). The pressure from the social system and the Pathan code of honour, which prevails specifically in the area, binds the people to perform different festivals in accordance with their socio-cultural obligations. In case of capital constraints, they borrow from friends and relatives to finance such festivities to keep up their social status.

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Table 4: Utilization of Credit in six Villages in Northwest Pakistan, 2005-06

Purpose	Credit Sum in 100 Pak. Rs.						
	0 - 25	26 - 50	51 – 100	101 - 500	501 - 1000	over 1000	Total
Consumption	1	3.8	4.7	4.9	0.9	0.1	15.4
Farm-Invest.	.3	1	1.3	2.6	1.1	1.9	8.2
Festivities	0.1	1.1	3.6	14.2	3.2	0.5	22.7
Housing	0.1	1	2.9	9.1	2.2	1.1	16.5
Land purchase	0	0	0.1	1.1	0.7	0.3	2.1
Medical Treat.	1.2	2.1	4	9.3	1.2	0.5	18.4
Off-Farm-Invest	0	0.9	2.1	6.1	3.1	3.8	16
Other Purposes	0	0	0	0.3	0.1	0.2	0.6
Total	2.7	10	18.8	47.6	12.5	8.3	100

Source: Field Data, 2005-06

The utilization of credit for off-farm investment however showed slight increase with time. It rose from 11% in 1986-87 to 16% in 2005-06. The increasing tendency of rural people migrating abroad (Gulf countries) was one of the reasons. To finance the initial costs of visa, ticketing and payments to the overseas employment agents; they had to borrow.

Table 5: Utilization of Credit in Six Villages in Northwest Pakistan, 1986-87

Purpose	Credit Sum in Pak. Rupees 100						
	1 - 25	26 - 50	51 – 100	101 - 500	501 - 1000	over 1000	Total
Festivities	5	4	6	5	0	0	20
Medical Treatment	5	2	1	2	0	-	10
Land Purchase	0	1	1	1	-	-	3
Housing	4	4	5	4	1	0	18
Farm Investment	4	3	3	3	1	0	14
Off-Farm-Invest	2	1	3	3	1	1	11
Consumption	12	5	2	0	0	-	19
Other Purposes	1	1	1	2	-	-	5
Total	33	21	22	20	3	1	100

Source: Manig, 1991

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These findings suggest that the effectiveness of informal credits, especially from friends and relatives still remained dominant in the area. As social festivities are frequently celebrated, therefore, large number of small transactions came to finance them. Contrarily, large amounts of informal credit were used for financing off-farm, income generating activities. This shows that informal credit not only maintains the traditional and social heritage of the people but also provides them a platform to settle new livelihood strategies which changes the social-production relations among people in the long run.

The findings elaborated in the above section reveal that inter-dependencies of people have been reduced with time due to modernization and urbanization influencing factors. This has led to change in the traditional informal credit systems in the area. Consequently importance and efficiency of the commercialized credit system has increased. Thus the hypothesis that changes have incurred in agricultural credit systems in the area stands accepted. The effects of changes in the credits systems in the area have also led to changes in the societal norms and rules. The utilization of credit for different purposes has incurred slight changes which reflect changes in people's tastes and preferences over time. However, these changes have incurred so slightly that are too difficult to determine. Institutional change, as widely accepted, is so slow and smooth process that cannot be determined in few decades. In a period of four decades however, the agricultural credit systems has exhibited minor changes in institutional changes in the traditional society in the area. Thus the hypothesis that changes in agricultural systems have influenced institutional changes in the area is supported by the study as well.

5. Conclusion

In order to identify and analyze changes in agricultural credit system and its impact on institutional change, this study was conducted in Northwest Pakistan in 2005-06. The findings of the study showed that both formal and informal credit institutions existed in the area. Although formal credit institutions expanded their network and launched special schemes for agricultural credit; still this system did not fully correspond to the capital requirements of the majority of potential borrowers. This was because of the strict security and collateral requirements, which most of the farmers could not fulfill. In the heterogeneous social system in the area, the elite groups extracted more benefits from the formal credit schemes. In this situation, the most reliable and frequently accessible informal credit institutions performed their vital role to control the possible expansion of social polarization in the society. The multi-stranded economic and social network of relations among people that already existed in the area provided a base for the credit relations. It shows that the mutual-financial assistance in the time of need is a reflection of the strong socio-economic ties among people in the area.

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The village wise comparison showed larger procurement from the formal lending institutions in Mushtarzai, Dalazak and Yousafkhel, which were under direct influence of the business and administrative centre Peshawar. Contrarily, the informal institutions dominated in Gulbela, Kochian and Dalazak which are traditional villages with less influence of the urbanized Peshawar. The study concluded that despite the development of commercialized credit institutions, the informal credit institutions, which were based on the principles of reciprocity and mutual help, dominated the newly established formal credit institutions.

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