Islamic Alternative to Existing Agricultural Credits: A Study of Agri-Credit System of Pakistan

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Abstract

Agricultural sector is the backbone of Pakistan but there are a number of problems and challenges for agriculture sector in Pakistan. In this regard, agricultural sector is facing mostly credit- related financial problems among the framers. The Islamic *Shariah* has provided solutions to these problems through various Islamic financial contracts including *Salam*, *Musaqat*, Muzaraat and *Mugharasa* but the effectiveness of these contracts can only be possible if required institutional and infrastructural facilities are adequate for their applicability. Keeping in view this, the current research studies the issues related to the applicability of these *Islamic* financial contracts in Pakistan through *Islamic* banks. The main objective of the research is to review the issues in agriculture credit system of Pakistan through banks and the scope of *Salam* contract as an effective alternative. The research also focusses on the problems in *Salam* agriculture financing through *Islamic* banks. The study has applied the qualitative research method. The data for the research has been collected through semi structured interviews of ten bankers of Islamic banks. Besides this, expert opinion of the five eminent religious scholars has also been sought. The data collected is then processed through thematic content analysis. The findings revealed that there are problems of insufficient institutional credits for farmers, very high rate of interest, issues in managing collaterals and exhausting credit procedures in existing agricultural financing. It is also observed that *Salam* financing through banks is inefficient because required infrastructure facilities are not available. Therefore, it is recommended through that farmers should be provided *Salam* based credit financing through institutions other than IBs.

Keywords: Agriculture credit, Salam, Islamic banks (IBs), Muzaraat, Collateral

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1. Introduction

Agriculture is a major economic sector in Pakistan and it is considered important for economic growth, employment and poverty alleviation. It added 19.2 % of GDP and employs 38.5% of labor force. For the livelihood, more than 65-70% population is dependent on the agriculture sector (Pakistan Economic Survey (PES), 2020-21). The agriculture sector in Pakistan is an important source of raw materials for the industrial sector and also contributes to revenue generation. Pakistan is known for its abundance in agricultural activities including fertile lands, favorable climate, extensive irrigation systems and industrious workers (Ahmed, D., et al., 2020). Pakistan is a major exporter of most agricultural products and is one of the top ten producers of wheat, cotton, sugarcane, Kinnow, oranges, mango and dates (Food and Agriculture Organization, 2016).

The agriculture sector of Pakistan has various characteristics such as traditional farming, illiteracy and poverty of farmers, water scarcity and electricity failures etc. Lack of financial resources is a major obstacle in obtaining high quality seeds, fertilizers and pesticides (Ahmed, D., et al., 2020). The yield per hectare of the main crops in Pakistan is 2747 kg less than Bangladesh, India, China and Malaysia. Farmers often seek financial assistance from lenders to meet their financial needs. These lending facilities calculate high interest rates which add to the difficulties of farmers (Hossain, I., 2019). In South Asia, mortgage lenders are called "migrants" and are known to exploit farmers in terms of loans (Meemken E. M., & Bellemare M. F., 2020).

Agriculture sector of Pakistan is supported by natural resources like rivers, variety of seasons, mountains, irrigations system, lakes and tillable agriculture land (Food and Agriculture Organization, 2016). In the presence of all these resources, the performance of agriculture sector is not up to the mark rather it has been deteriorated for last few years. This affected the overall agriculture sector especially small and large farmers socially and financially. The reasons of agricultural sector's poor growth are mainly poor agricultural credit facilities for farmers, lack of reliability of the farmers on the banks for financing, high interest rate, complicated procedures of loan application, costly inputs, lack of water irrigation, older methods of cultivation (Ahmed N., Khan A. and Mansoori M. T., 2018; Ahmed N., Khan A. and Mansoori M. T., 2019). Besides this, poor farmers rely mostly on their credit needs on middle man, shopkeepers and money lenders who exploit the poor illiterate framers (Ahmed N., Khan A. and Mansoori M. T., 2019; Kaleem A,. & Wajid R., 2009).

The current credit system of the Pakistani banks is non *Shariah* compliant, interest based and exploitative. It has not addressed the problems of the poor farmers properly and efficiently. So, there is need of the efficient and proper *Shariah* compliant mode of agriculture financing. *Salam* is one such mode which has been tested in the past and equally suitable in modern times to tackle the needs of the farmers (Kaleem A., & Ahmed S., 2010; Rahma S.T.M., 2020). However, it is observed that in the banks of Sudan and Indonesia, *Salam* has shown lower than the expected performance (Hudaifah A., Tutoko B., & Sawarjuwono T., 2019)

The objective of this research is to highlight the issues related to agriculture credit through banks faced by the poor agriculture farmers and the inefficient performance of *Salam* contract through *Islamic* banks. The study provides the possible solution to the problems of current agriculture credit system for farmers through banks by highlighting the *Shariah* compliant agriculture credit facilities. Salam is one such alternative which has also some institutional and management issues. The current research suggests that with proper planning and institutional support, it can be made more effective in supporting the agricultural sector of Pakistan.

2. Literature Review

Under the Islamic banking system, risk is shared between borrower and lender because interest is forbidden by the business and the business is supported by real estate. Unlike traditional banks, which use the currency as a commodity for trading, currency is regarded as the only exchange instrument. In addition, banks cannot conduct certain transactions under Islamic law such as alcoholic beverages and gambling (Ayyub S. et all., 2020; Zauro, N.A., Saad, R.A.J. and Sawandi, N., 2020). In general, Islamic banks accept the principles of Islamic law and conduct their business in accordance with these principles. However, in real estate business, they sometimes differ due to variables such as specific country laws, bank objectives, and the need to negotiate with traditional banks. Islamic bank accounts are divided into three types: checking or depositing accounts, investment accounts and savings accounts (Hussain M. K., 2020)

It is evident that the main problem with agriculture is the source of funding. At the same time, due to the knowledge of high risks and the extremely low capacity of agricultural human resource conservation, the role of Islamic banks in agriculture is inadequate (Chamberlain T., Hidayat S., & Khokhar A. R., 2020: Saqib L., et all., 2015). Banks, as financial intermediaries, play an important role in providing financing channels for all economic sectors especially the agricultural sector (Ahmad, D., Afzal, M. & Rauf, A. 2020). The banking industry in Pakistan focuses on corporate and consumer financing (Ben Mimoun, M., 2019; & Faizulayev, A. 2021). Although some advanced landowners are familiar with modern methods, most farmers are not familiar with the advanced technology. Pakistan is a major exporter of agricultural products to many countries including Europe, the United States and the Middle East (Kaleem A., & Abdul Wajid R., 2009).

Farmers are facing serious issues in getting credit for agriculture inputs from banks, middleman, shopkeepers, money -lender relatives and friends. Banks only fulfill 30-35% of farmers' financing needs for agricultural crops inputs to hire the labor and to pay rent for hiring machinery (Rahma S.T.M., 2020). To fulfill their financial needs, approximately seventy percent of the farmers has to depend on the credit market. They have also perceived that if they purchase inputs on cash, they can save 25% of cost (Kaleem A., & Ahmed S., 2010; Rahma S.T.M., 2020). In the FY 2021, the total target allocation of agricultural credit is Rs.1500 billion. This fund is allocated to different proportions to 50 agricultural lending institutions including 5 Islamic banks (Pakistan economic Survey, 2020-2021) (See Table 2.1). This shows that their reliability on these credit institutions is less than expected.

Table 2.1 Supply of Agriculture Credit by Institutions

Banks	**Target FY 2021**	**FY 2021 (July-March) Rs. Billion**	
		Disbursed	**Achieved %**
Major commercial banks (5)	800	554.2	69.3
ZTBL	105	56.5	53.8
PPCBL	13	5.2	39.8
DPBs (14)	296	192.5	65.0
Islamic banks (5)	63	35.9	57.0
MFbs (11)	182	92.8	51.0
MFIs/RSPs	41	16.6	40.5
Total	**1500**	**953.7**	**63.6**

Source: State bank of Pakistan

Besides this, the rate of interest is another issue which hinders the farmers not to focus on the credit from the institutions (Alam M. K., et all 2021). This factor discouraged the people in Pakistan to rely on bank for their financial needs as compared to other sources of lending (Alam M. K., & Miah M. S., 2021; Abd Rahman, N., Mastuki, N., Osman, M.R. and Kasim, N. (2020). In countries like Pakistan, Iran, and Afghanistan, people are more conservative in the matter of interest and even they are also doubtful about the products offered by IBIs (Hadji Latif S. D., 2021). About the *Shariah* compliance performance of some of the *Islamic* banking products, *Bai Muajjal, Bai Murabaha, Bai Salam, Bai Istisna* and *Ijarah* is also observed as doubtful and unjustified (Ben Mimoun, M., 2019). People approach Islamic banks because of their adherence to *Shariah* compliance characteristics and Shariah boards' endorsement . (Khalil, A., 2021; Tabash, M.I., et al.,2021; Alam, M.K. and Miah, M.S. 2021; Adedeji, B.S., 2021). Moreover, different lending institutions and banks charge different rates of interest from farmers. ZTBL under govt. of Punjab's markup free agriculture e-credit scheme charges markup over loan with rate of 12.50% p.a. (Zarai Taraqiati Bank Limited (ZTBL), 2021, December 8).

Besides these exploitative perspectives of private lending bodies, farmer's debt burden has added to the miseries of the poor farmers. As private lenders charge very high interest rate over loan ranging from 65% to 80% (Asim E., Shahzad M. A., 2015; Ahmed N., Khan A. and Mansoori M. T., 2018). The studies show that due to expensive borrowing from private sources, farmers remain unable to get high financial status in society (Umar, U.H., 2021). Their progress becomes handicapped and they remain under debt for generations (Elgharbawy, A. 2020: Junaidi, J. 2021).

3. Methodology

The current research has applied the qualitative research method. The convenient random sampling has been used to select samples of the research. The data for the research has been collected through semi structured interviews of ten bankers of Islamic banks located in Punjab. Besides this, expert opinion of the five eminent religious scholars has also been sought .

The current research studies the issues related to applicability of the *Islamic* financial contracts in Pakistan through *Islamic* banks. The main objective of the research is to review the issues in agriculture credit system of Pakistan through banks and scope of *Salam* contract as an effective alternative through other institutional means other than banks. These objectives of the research are achieved through the processing of the data collected by thematic content analysis. Bankers and scholars' opinions are analyzed through this method to develop the findings and recommendations of the research.

4. Analysis and Discussion

After analyzing the data, it is found that lack of interest, adequate and timely credit can improve the social and economic status of farmers, increase productivity, create jobs and improve modern agriculture. In addition to that, it is also found that debt has become a strain on farmers, and it is difficult to improve the conditions of poor farmers and improve the agricultural sector without access to easy credit system. However, agricultural loans provided by Pakistani institutions and non-institutional sources have some serious problems. Most of the credit is provided by non-institutional sources, such as middleman, shopkeepers, professional lenders, relatives and friends which have the factor of exploitation. The agricultural farmers have no choice but to rely on conventional methods and other resources to meet the financial needs. Despite the debt gap, collaterals, excessive interest rates, and long and difficult processes have also intensified the problem.

Similarly, different agricultural credit supporting schemes of banks become more expensive, and different banks charge different processing fees. Clients are required to pay an official reporting fee, asset inspection fee and bank processing fee. In addition, bribery, processing and complex guarantees make the cost of getting a business loan very high. High interest rates are one of the biggest problems faced by farmers from different banks charging different interest rates.

Moreover, interest-bearing debt has caused serious social and economic problems for poor farmers. High interest rates affect farmer's growth rates and the national economy. The debt crisis has been identified as the main cause of problems for many farmers. The negative impact of Pakistan's agricultural inefficiency is reflected in the increase in the trade deficit. Due to low yields and increased dependence on agricultural food imports, this puts a lot of pressure on foreign exchange reserves. As a result, Pakistan's trade deficit has worsened in the past few years.

It is also observed that most important thing for people to choose *Islamic* banks is to see Islamic bank following *Shariah* principles. Also, religion is the most important thing for people to choose *Islamic* banks. It is also seen that the products offered by Islamic banking institutions are partially in compliance with the *Islamic* teachings.

In Pakistan, the Committee for *Islamic* Thought (CIT), the Federal *Shariah* Judicial Organization, the Ministry of Food Safety and Research (MNFSR) and a number of studies has proposed an interest free credit system for farmers. In this context, *Salam* is recommended and is used to support the financial requirements of the farmers in Pakistan. *Salam* contract is helpful for the small scale and medium sized farmers and helps them to rely less on the non-institutional ways of getting credit but in Pakistan, it is found that *Salam* has not been used as mode of financing for farmers to meet their crop input needs rather it has been used by few *Islamic* banks for the small scale financing of some sugar cane industry, poultry etc. There are various factors like *Shariah* non-compliance, heavy *collaterals and processes of the banks which have affected the expected performance of this* mode. Other factors which have affected performance of this mode are lack of knowledge, training and skills of bank employees regarding *Shariah* compliant mode of financing which has always been annoying to customers.

4.1 Salam Models and their Effectives in Applicability

If different models analysed in previous studies, it is observed that Rasheed and Mudassar (2010) have suggested middleman as agent of the bank model. In this model, middle man, being agent of the bank, charges agency fees on the basis of *Waqala* contract but this model has not worked, as in this model farmers remain dependent on the middleman or "*Artis*" who most of the times exploits poor farmers. Moreover, parallel *Salam* model is another model which eliminates the involvement of the middlemanbut this model does not comply with the true spirit of *Salam* contract which is allowed as an exception to the sale contract by Prophet (pbuh). It is allowed to meet the poor farmers' financing needs instead of their reliance on interest- based loans. Therefore, banks cannot use parallel *Salam* as they do not face any such problem of finance.

Asim E., Shahzad M. A., (2015) has proposed a *Salam* model where there is direct contract between bank and farmers. Bank inspects the land where crop is cultivated and forecasts the price depending on the past five or ten years' prices. Everything related to quality, quantity, price, and date of delivery of the commodity is documented at the time of the contract. Full Price is paid by the bank to the farmer in advance and for the security of delivery of the product, bank can demand mortgage or collateral from the farmer. At the time of the delivery, farmer can become the agent of the bank to sell the crop in market but this agency contract should be separate and is not contingent upon the

Salam contract. This model seems to be simple and directly gives financial benefits to the farmers but it also has some risks in it like risk of delivery, commodity risk, price risk, quality risk etc. Besides this, it also involves high cost of managing agricultural specialist to examine the quality of crop, land etc.

Another effort in this regard has been put made by Saiti, B., Afghan, M., & Noordin, N. H., (2018) in presenting the *Salam* based crowdfunding model. In this model there are farmers, investors, trustee, crowdfunding operator (CFO) and *Shariah* review committee. In this model, investors provide funds to the trustee who reviews its investment and passes funds to crowdfunding operator. CFO then concludes a *Salam* contract with farmer and gives the farmer the advance price of the product. CFO then gets the commodity on the delivery date as decided earlier and sells commodity in market on current price. Then, after deducting management costs etc., he shares capital gains with the investor. *Shariah* review committee has the responsibility to evaluate all the process according to *Shariah* principles. Besides its advantages, this model has some drawbacks as it's too lengthy and involves many people. It also has various risks and costs of functioning. In this model, trustee gets less financial advantages as compared to CFO and investors. It is also not clear in this model that what sorts of *Shariah* compliant contracts are concluded between investor, trustee and CFO.

Another effort in this regard has been put forward by the Hudaifah A., Tutuko B., Sawarjuwono T., (2019) by introducing *Salam* based *Islamic* Corporate Social responsibility (CSR) model for agricultural financing. In this model, local government through *Ullema* council motivates companies to contribute to the banks and Zakat institutions on the basis of Islamic CSR. The banks then conclude *Mudarabah* contract with the farmers' group organization on the basis of *Islamic* CSR. Then the farmers' group organization concludes *Salam* contract with the rice commercial farmers who also have some subsistent rice farmers. On the conclusion of the *Salam* contract, these commercial farmers deliver rice to this farmer group organization who then sells it in the market. The farmer group organization shares the profit margins settled in *Mudarabah* contract with the *Islamic* banks. Subsistent farmers also get their share from the *Zakat* Institution being the recipient of the *Zakat* fund. This model needs two contracts basically *Mudarabah* and *Salam* but there is no specification of the contract between companies and *Islamic* banks. Also, this model involves large number of people and institutions which becomes quite laborious and costly in managing and motivating them.

Zakat-based-*Salam* Model is suggested in the study conducted by the Hossain, I., Muhammad, A.D., Jibril, B.T., & Kaitibie, S. (2019). In this model, small holders' farmer makes village level cooperatives who receive *Zakat* funds from *Zakat* management company (ZMC) on the basis of *Salam* contract. The cooperatives also use some of these funds to buy inputs and offer inputs and working capital to the farmers. On the basis of agreement, these farmers then deliver the crop to the cooperatives in future. Finally, these cooperatives deliver the crop to the food bank besides this model's socio-economic advantage through private channel, it is country specific.

In Pakistan, another model of *Salam* based financing for the agriculture farmers is offered by the private body *Wasil* Corporation in 2009. In just a few years, *Wasil* built its warehouse with a storage capacity of 800 tons of factories, and with 430 tons, it has the capacity to increase it to 2,300 tons. This corporation has attracted the farmers by substituting the middleman, shopkeepers and private lenders. Farmers are satisfied with its easy procedures, lower rate of return and *Shariah* compliant working.

5. Conclusion

These discussions show that the agriculture credit system contradicts Islamic teachings. It does not help farmers and does not promote agricultural development in the country. The research found that there are problems of insufficient institutional credits for farmers, very high rate of interest, issues in managing collaterals and exhausting credit procedures in existing agricultural financing. It is also observed that Salam financing through banks is inefficient because required infrastructure facilities are not available. On the basis of the analysis of the different country models, following recommendations are made

1. It is recommended through this research that farmers should be provided *Salam* based credit financing through institution other than IBs.
2. *Zakat* Institutions in the country can be mobilized to manage funding requirements of the subsistent farmers on the basis of *Islamic* CSR and *Zakat* based *Salam* model.
3. Also *Salam* based crowdfunding model can be utilized for agriculture credit facilities.

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