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The Limits of Success?

NGOs, Microfinance and Economic Development in Pakistan's Northern Areas

Feisal Khan
khan@hws.edu
Dept. of Economics
Hobart and William Smith Colleges
Geneva, NY 14456

September 2008

For its advocates, microfinance has become a near-panacea for ensuring that the poor of the developing world would benefit from growth and development. In short, microfinance would ensure that trickle down would actually trickle down. Microfinance became more than 'just' a policy option when its staunchest proponent spoke of it in moral and social justice terms: Muhammad Yunus, the Nobel laureate founder of Bangladesh's Grameen Bank, declared access to credit as a basic human right.

One of the world's largest and most successful rural development Non-Governmental Organizations (NGOs) is the Aga Khan Rural Support Program (AKRSP), operating since 1982 in Pakistan's Northern Areas (NAs). Despite covering over 85% of the NAs million-plus rural population and offering a full range of rural development services (credit, agricultural, forestry and veterinary extension training, business consulting services, civil engineering, etc), the AKRSP has been relatively unsuccessful in facilitating a successful transition to a market-oriented focus among its overwhelmingly subsistence-farmer beneficiary base. The AKRSP has devoted substantial resources to trying to create a successful and self-sustaining microenterprise culture among its clients but its results have been far from encouraging.

Given how few NGOs fall into the 'successful' category and how few have AKRSP's resources and institutional resources, AKRSP's relative failure to promote successful microenterprises in the NAs of Pakistan is a clear sign of the limits of microfinance success. While microfinance may well provide some hope for poverty alleviation and social welfare indicator improvement, it cannot provide all of the conditions necessary for sustainable economic development and long-term success for the poor.

Third Annual Himalayan Policy Research Conference
October 16th, 2008
University of Wisconsin, Madison

Preliminary Draft
Not for citation but comments would be welcome and greatly appreciated.

I Introduction

When Professor Muhammed Yunus of Chittagong University's Economics Department in Bangladesh first lent 42 poor village women a total of $27 in 1976, he could not have known that this would lead to the founding of the Grameen Bank, the creation of a revolutionary new field—microfinance lending—in economic development theory and practice, and, in 2006, the Nobel Peace Prize for his and the Bank's "efforts to create economic and social development from below" (Nobel Peace Prize 2006). Prof. Yunus has famously called access to credit a "human right" and argued that conventional credit institutions not only favor the rich but "in so doing have pronounced a death sentence on the poor" (Yunus 2003:150). Furthermore, Yunus argues, effective poverty alleviation requires that we "recognize every single human being as a potential entrepreneur" and in so doing realize that "the poor themselves can create a poverty-free world" (Yunus 2003:250). Yunus, it appears, is arguing that making credit available to "the poor" would allow them to carry out a range of commercial activities that would increase their income and thereby greatly reduce, if not outright eliminate, poverty.

Prof. Yusuf's Grameen Bank experiment in microlending has, of course, had tremendous success, growing from a handful of beneficiaries to approximately 7.27 million (96.7% female) by 2007; total funds disbursed reached over $6.4 billion, with an astounding 98.4% cumulative recovery rate. The Grameen Bank is much more than a microfinance institution making loans to poor Bangladeshis. It is actually a very large conglomerate providing a variety of services (life insurance, fishery development, telecommunications services, and so on) to some of the world's poorest people. Furthermore, since 1995, it has operated on a self-financing basis and no external donor funds are used in its various operations.[1] There are now some 30 countries with microfinance programs patterned on the Grameen Bank's (De Aghion and Morduch 2005:12).

Like Bangladesh, Pakistan ranks among the world's poorest countries. As Table I indicates, Bangladesh and Pakistan (one country prior to the 1971 Civil War) both have an extremely high number of people subsisting at a very low subsistence level. Inspired in part by the example of the Grameen Bank in Bangladesh and earlier development work done there in the 1960s, the 1980s saw the establishment in Pakistan of two large Non-Governmental Organizations, the Aga Khan Rural Support Program (AKRSP) and the Orangi Pilot Project (OPP), with a large microfinance component.

Table I: Basic Poverty and Population Data

Country	**GDP/capita (constant 2000 US$)**	**Population**	**Percentage of population living on $2/day or less**
Pakistan (2002 data)	1,842	145 million	74
Bangladesh (2000 data)	1,543	129 million	84

Source: World Bank, *World Development Indicators 2007*

The focus of this paper shall be on the microfinance and commercial enterprise development experience of the AKRSP and its microfinance successor organization, the *First Microfinance Bank*, in Pakistan's remote Northern Areas (NAs). While the AKRSP has been successful in extending microfinance to the subsistence farmers of the NAs, how successful have they been in creating self-sustaining economic development via the growth of commercially successful microenterprises? That is, after two decades of continual work, are the enterprises financed by the credit AKRSP made available to small borrowers commercially successful and sustainable ones?

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[1] Data from *Grameen Bank Monthly Report*, August 2007; for more details on the Bank and its range of services, see the Grameen Bank website, http://www.grameen-info.org/.

It is a truism that it takes money to make money. Obviously all successful entrepreneurs require access to credit but does access to credit guarantee a successful entrepreneur? This paper will argue that while a lack of credit may automatically doom a project, obtaining credit is no guarantee of success.

II The AKRSP and Rural Development

The Northern Areas (NAs) of Pakistan[2] are among the remotest and most inaccessible parts of the world. They are also among the poorest: "Based on 1998/99 data, the average person in the NAs is still living on about 50 cents US per day" (World Bank 2002:37). The NAs cover an area of 74,200 km^2 and have an estimated population of 1,086,057, almost completely rural and subsistence farmers, in 2000. The people of the NAs speak five mutually unintelligible languages and are scattered across some 1,123 villages and a few small towns across in rugged terrain and the AKRSP serves over 85% of all rural households in the NAs (World Bank, 2002:76-77). Most of the land is above 1,200 meters altitude, with permanent settlements as high as 3,000 meters. The logistics difficulties of operating in the region are made starkly obvious if one considers that five of the world's fourteen 'eight-thousanders' (i.e., peaks over 8,000 meters in height) are located in the NAs.

The basic unit of the AKRSP is the Village Organization (VO) through which the AKRSP channels all of its development efforts. To qualify for AKRSP assistance, a prospective VO must hold a series of meetings, organize at least 75% of its households and each household

[2] The NAs comprising of Gilgit, Ghizar, Diamir, Astore, Skardu and Ghanche districicts are a *de facto* fifth province of Pakistan; the AKRSP's program area includes a district of the North West Frontier Province, Chitral, as well as the NAs proper. Gilgit district is the largest in population (35% of the total) and most economically developed part of the NAs.

must start regular contributions to its own savings account,[3] and elect a VO Manager and Bookkeeper. Finally, the VO must decide upon an initial project to be funded by the AKRSP and which will deliver tangible economic benefits. This project usually involves irrigation since all agriculture in the NAs is irrigation-dependent.

The AKRSP maintains a very successful integrated rural development program that includes the all-important social organization component, as well as agricultural, livestock, commercial marketing, forestry, human resource development and technical training, appropriate technology, rural credit and women-in-development components. It also includes a small-scale (village level) civil engineering section. It provides infrastructure (roads, bridges, irrigation systems and rural electrification), human capital development (agricultural and livestock extension training; primary and secondary education is in conjunction with the Aga Khan Education Services), and basic healthcare (in conjunction with the Aga Khan Health Services).

The AKRSP, although it is not a World Bank project, has been evaluated four times by the World Bank's Operations Evaluation Department on behalf of its external donors. These evaluations (in 1987, 1990, 1995, and 2000) have been almost uniformly laudatory and often contrast the AKRSP's results to the Bank's own much less effective rural development track-record. In 1990 the Bank stated that, "At a time when 'rural development' as a development strategy is out of favor, the AKRSP experience provides a hopeful prospect that rural development can be made to work" (World Bank 1990:5). The Bank’s most recent (2002:xiii)

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[3] The initial savings contributions were often minimal. The intention was to get the villagers used to making regular contributions to their individual (informal VO level) savings accounts, which were then pooled together into a formal VO savings account at a regular bank. Records were kept of each household's share of the VO account and each household's contribution was its own and did belong collectively to the VO. These savings then served as collateral for loans made to the VO by the AKRSP. By 2000, the total value of member savings had reached Pakistani Rupees (PKR) 429 million (~US$ 6.7 million) while the total value of loans outstanding in 2002 was PKR 142 million (~US$ 2.2 million) (World Bank 2002:103). In 2002 all VO savings and loan obligations were transferred to the First Microfinance Bank, Ltd., the successor credit institution to the AKRSP’s credit and loan program. All exchange rate conversions in this paper are made using the World Bank determined annual average exchange rate reported in World Bank (2002) for the year(s) in question.

evaluation concluded that almost two decades after its inception, the AKRSP's "achievements have been remarkable and, unlike many other donor-funded interventions, sustained."

Like the Grameen Bank, the AKRSP also emphasized the importance of access to microcredit for its beneficiary households as agricultural credit is as vital a production input in an agrarian economy as, say, fertilizer. Without ready access to sufficient credit, agricultural production and productivity is severely affected. Given their limited financial resources, subsistence farmers are, of course, severely hurt by the inability to obtain agricultural credit. Prior to the AKRSP's formation, the large farmers in the region monopolized almost all of the formal agricultural credit available. In Gilgit in 1983 the AKRSP disbursed US$ 54,198 in short-term production loans to 4,050 farming households, for an average loan size of US$ 13.38. In the same year, three years *after* the inception of the Pakistani government's interest-free small-farmer production loan program, not one of the 28,000 eligible small farmers in Gilgit had received a loan from the agencies responsible for its implementation. Gilgit's large farmers monopolized institutional credit: 16% of all farmers received 47% of total formal sector credit disbursement.[4]

In 1991, almost a decade later, the situation was essentially unchanged. Total formal sector credit disbursement of US$ 5.46 million went to 2,600 borrowers for an average loan size of US$2,100, while the AKRSP disbursed approximately US$ 1.13 million among 30,000 small farmers for an average loan size of $38.[5] By 1997 the average loan size had reached $158,[6] due mainly to the AKRSP introducing several different credit products, including Corporate and Enterprise Credit Loans (Hussein and Plateau 2006:328)

[4] See Aga Khan Rural Support Program (1991:85) for details.

[5] Aga Khan Rural Support Program (1992:95) for details.

[6] Calculated from Table 7.1.1, Aga Khan Rural Support Program (1998).

The AKRSP has attempted to reduce the subsidy element, and minimize the severity of the resulting 'dependence culture,' inherent in all such projects. For example, when the AKRSP began encouraging farmers to increase fertilizer use, it made them fertilizer loans at market interest rates[7] and organized buying trips to nearby towns so that VOs, and not AKRSP agents, bought the fertilizer in bulk at wholesale rates. While the AKRSP paid the initial transportation costs, farmers had to pay the actual cost of fertilizer and organize next year's buying trips on their own (with some AKRSP non-monetary assistance if needed). Most loans, except those for land development or large farm machinery purchase, were made on an annual basis and future loans were contingent upon satisfactory repayment of current ones.

Following the same operating pattern as the Grameen Bank, the AKRSP made a lump-sum credit disbursement to the VO as a whole instead of to individuals and the VO was responsible for individual loan decisions and eventual repayment of the loan plus interest. While there existed a short-term individual free-riding default incentive, long-term village-level benefit flows required that VOs ensured loan repayment. The VO thus internalized monitoring costs and so reduced the cost to the AKRSP of administering a relatively large-scale credit program. For example, there were early reports of villagers deciding to repay individual defaults out of village savings and then auctioning off the defaulter's assets to recompense the VO (Khan and Khan, 1992).

While default rates for short-term (less than one year) loans were virtually zero, longer term loan defaults increased over time: by end-1994, medium-term "Micro-enterprise Credit" loans had a 27% default rate but since only 3% of loans were more than six months overdue, the World Bank's 1995 AKRSP evaluation attributed most of the default problem as being a simple

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[7] This has not changed over time. The World Bank (2002:106) calculated that the AKRSP did not directly subsidize its then lending program.

timing issue: the lump-sum credit disbursement to the VO meant that all the longer-term loans had a uniform due date that did not match the actual cash-flow of individual borrowers (World Bank 1995:86). However, the AKRSP reacted proactively by phasing out certain types of the more problematic longer-term loans (e.g., land development) and dedicating more resources to managing the loan portfolio and auditing individual VOs (World Bank 2002:105-106). Although only 5.6% of AKRSP's entire loan portfolio of PKR 142 million (US$ 2.2 million) in 2000 was viewed as being "at risk" (World Bank 2002:26 & 103), the AKRSP was in the process of rethinking its entire credit program due to the increasing demand for a wider range of credit options and the resulting increase in administrative costs and persistent loan recovery issues in longer term loans.

By 2000, the AKRSP's training program had trained 20,587 people in skills ranging from elementary bookkeeping and accounting to traditional rural development extension work (agricultural, veterinary and forestry) to basic marketing and Traditional Birth Attendants (World Bank 2002:92). By the same year, the AKRSP's small scale civil engineering program, the Mountain Infrastructure and Engineeering Services (MIES) program, had completed 1,917 separate public works projects, including several hundred kilometers of link roads, bridges, irrigation projects and protective dikes (World Bank 2002:85). The importance of the MIES work in this incredibly rugged, mountainous area cannot be overemphasized. For example, the completion of a link road for a remote village not only improved its access to markets but actually greatly reduced its maternal and infant mortality rates since it reduced the travel time from to the nearest hospital from *two days walk* to two hours by jeep (World Bank 2002:9).

The MIES was responsible for 167 microhydel projects (i.e., 167 villages electrified) and one fourth (48,000 hectares) of all cultivated land in the NAs, a subsistence economy where 60%

of household income comes from farming (World Bank 2002:28 & 30). Finally, AKRSP Household Income and Expenditure Surveys indicated that, between 1991 and 1997, real per capita household income in AKRSP VOs increased 260%, with individual households attributing between 10-50% of this increase to AKRSP activities (World Bank 2002:9).

In spite of the difficulties of operating in the NAs and the scale of its operation, the AKRSP is not an inordinately expensive program. The estimated cost (in constant 1988 dollars) for the AKRSP for the 12 year period 1983-1994 was approximately $500 per beneficiary household, much less than the $1,000 per beneficiary household for comparable World Bank programs for a six to eight year period (World Bank, 1988:48) and these costs had not increased significantly in the period 1994-2000 (World Bank, 2002:12).[8] Between 1982-2000, total AKRSP expenditure was US$ 89 million, peaking at US$ 9.29 million in 1998 before declining to US$ 4.89 million in 2000, and there is no evidence of escalating per beneficiary spending as being responsible for its institutional success (World Bank 2002:96). This is in direct contrast to a common allegation in Pakistan that AKRSP's success is due to its lavish and ever-increasing budget and very high cost per beneficiary household.

The AKRSP thus has a long record of successfully delivering needed goods and services to its beneficiaries at a relatively low cost. Khan and Tessendorf (2001) attribute AKRSP's success to its focus on delivering 'demand-side' development, i.e., focusing on what the beneficiaries actually want rather than what some distant government bureaucrat or development planner thinks they should have.

In November 2001, following the issuance of the Microfinance Ordinance by the Government of Pakistan, which created a legal foundation for specialized microfinance banks,

[8] However, while comparatively cheap by World Bank project standards, the AKRSP per beneficiary spending, while within the range of all (World Bank and locally sponsored) large rural development projects, it is at the high end of this range. Given the logistics difficulties of working in the NAs, this is not surprising.

AKRSP's extensive microfinance operations were transferred to the newly established First Microfinance Bank Limited, FMBL (*Voice Magazine* 2005). The AKRSP owns 45.45% of FMBL's shares outstanding, while the Aga Khan Agency for Microfinance owns 30.3% and the World Bank's International Finance Corporation owns the remaining 26.67%. Thus FMBL is essentially a subsidiary of the AKRSP and a member of the wider Aga Khan Development Network of which AKRSP is an important component.[9]

The decision to hive-off microfinance from the AKRSP's development work was made after increasing loan delinquencies in larger longer-term loans, unrest among some members due to the AKRSP's policy of deducting loan defaults from the VO's collective savings given as collateral to the AKRSP, and disturbing reports of embezzlement and preferential lending practices among some VOs (Hussein and Plateau 2006:334 & 337).

These continuing issues, despite increasing the monitoring and auditing of intra-VO lending,[10] and several external consultancy reports (Dichter 2003:171-173) convinced the AKRSP's Board that major changes were needed in key AKRSP procedures. The AKRSP, which still had near-zero short-term loan defaults, decided to set up a separate agency to handle all microfinancing since its policy aim was to expand the economic development of the NAs through the development of local business enterprises. Commercial lending, it was felt, could be better administered through a private financial institution, leaving the AKRSP free to devote its

[9] During Fiscal Year 2006, FMBL disbursed PKR 1 billion (~US$ 16.67 million) in loans, virtually doubling total credit disbursement over Fiscal Year 2005. The average loan size in 2006 was PKR 19,000 (~US $ 317) at a weighted average annual effective interest rate of 28% (about average for most microfinance lending) and the Bank's average margin on loans was 9.9%. However, FMBL collects deposits from and lends to an all-Pakistan customer basis and is not confined to just the NAs as was the case with the AKRSP. However, MFBL is the largest such organization in the NAs, which constitute an important portion of its lending base. (All data is from Maqbool and Usmani 2007.)

[10] For example, between 1995 and 2000, the AKRSP increased its Micro-Finance section's field officers responsible for loan auditing and performance evaluation from six to thirty-one (Hussein and Plateau 2006:342).

energies to continuing its rural development work and integrating the subsistence population of the NAs into a market economy.

III Commercial Growth and Development in the Northern Areas

There is considerable empirical evidence to support Yunus's contention that conventional credit institutions discriminate against poorer borrowers; or at least that they favor the big and powerful at the expense of the smaller and poorer. Stein (2002:1913-1914) finds that large banks systematically discriminate against small businesses if these firms do not meet their predetermined balance-sheet based lending criteria, with the implication here that perhaps the loan amount is too small for large banks to bother with. This is in keeping with Cole *et al's* finding that in the US large banks

> employ standard criteria obtained from financial statements in the loan decision process, whereas smaller banks rely to a larger extent on information about the *character* of the borrower. (Cole *et al* 2004:1; emphasis added.)

Banerje and Duflo (2004:30-31) find that small firms in India face a severe bank credit crunch and, when bank credit is reduced, have to reduce their output, resulting in lower sales and profits. Since these are all small *formal* sector firms, inadequate access to credit is presumably even worse in the informal sector.

Since its inception in 1982, the AKRSP has followed a policy of encouraging its VOs to become better integrated into the private, for profit, sector in the NAs. It has, for example, encouraged some VOs to grow seed potatoes for sale to commercial buyers, producing higher quality eggs, chicken, milk, apples, cherries, apricots, etc., for sale to the hotels catering to Pakistani and foreign tourists. In this context, the AKRSP runs training courses to familiarize local farmers and VO agricultural and commercial extension workers in the basics of marketing, producing a uniform and standard quality product, and so on, as well as organizing initial marketing trips out of the NAs for selected farmers so that they can interact with vegetable and fruit wholesalers in a safe environment.

In short, for the last 20 years, the AKRSP has been trying to integrate subsistence farmers into the NAs commercial structure. Earlier, in the 1990s, the AKRSP also expanded directly into vocational training, providing such training courses as "hotel management, carpet weaving, school uniform stitching, quilt making, carpentry, plumbing, hair cutting, pottery making, [electrical] motor rewinding, mine blasting, gem-stone cutting and polishing, candle making and fabric dying" (Afzal 2006:2164). These courses vary in length from a week to six weeks plus; refresher courses are usually much shorter in duration.

For example, in 1997 alone, the AKRSP, in addition to its regular and refresher agricultural, forestry, appropriate technology and farm machinery maintenance, and veterinary extension courses, also ran training courses in concrete block making and home construction, poultry farm management, food processing, post-harvest crop storage, carpet weaving, embroidery, and shawl making, retail business management, carpentry, fruit and vegetable preservation and retail marketing,

In short, the AKRSP has tried to create a local business/market culture and create new human capital where previously, other than a few small shopkeepers, peddlers and traditional craftsmen, none had existed before. The AKRSP has

> provided business support directly on a one-to-one basis, established its own businesses, serviced larger groups through strengthening indigenous associations and of late it is trying to adopt a more facilitative role in strengthening local markets (Afzal 2006:259).

The AKRSP has continually revised its approach when it became clear that its chosen strategy was not succeeding. It's approach to private sector development and commercialization has had three distinct phases:[11]

1 VO Based Cooperative Marketing 1982-1991

Here the AKRSP 'encouraged' very strongly collective marketing of by its Vos in an attempt to standardize output (e.g., only eight of the estimated twenty different fruit varieties grown in the NAs had a commercial market), reduce prohibitively high transactions costs, and reduce the bargaining-power disparity between subsistence farmers and wholesale buyers. By 1988, 52.57% of all VOs were engaged in collective marketing but continuing problems with it (difficulty in reaching agreement among members, disputes over cost sharing, marketing recompensation, free riding, etc) resulted in the AKRSP abandoning this approach in 1991. However, a tiny minority of the most successful VOs continued collective marketing; by 1997 only 8% of VOs were collectively marketing their output but income per household involved had risen a staggering 20-fold, from Pakistani Rupees (PKR) 1,675 to PKR 34,064.

2 Alternative Approach to Enterprise Development 1992-2002

Realizing the failure of its collective approach, the AKRSP attempted to create the human capital infrastructure it thought was necessary for the successful commercialization of production in the NAs. In short, it attempted to lay the human and institutional capital foundations necessary for building a market economy. It provided marketing training, technical expertise and consulting services, underwrote the purchase of specialized machinery, arranged marketing trips, brought buyers up from down-country, and so on. It also set up a special entrepreneurial

[11] The following information in this section, unless noted otherwise, is from Afzal 2006.

credit fund where it financed projects for VO members (average loan size was PKR 300,000, ~US$ 7,500 in the mid-1990s).

Despite great initial enthusiasm and some minor successes (e.g., marketing locally produced honey, traditional cloth—*shu*, or women-run village-level tailoring businesses), the major ventures it promoted, a carpet-weaving firm, handicrafts manufacturing and marketing, fruit processing and jam making, etc, were not successful and ultimately folded. The main reasons for their failure was uncompetitively high production costs compared to their down-country rivals. In all, when this phase of AKRSP commercial sector development was essentially wound up in 2002, the AKRSP had directly supported 626 firms, trained 4,718 Yunusian "entrepreneurs" (51% of them women) and disbursed PKR 297.17 million[12] in loans in the period 1992-2002.

By the late-1990s it became obvious that commercial development in the NAs was not going to be as successful as the AKRSP had initially hoped for. The AKRSP decided to set up its own businesses in order to speed up the process of creating a market where none had existed before.

The three AKRSP enterprises established were the Dry Fruit Project (now renamed Mountain Fruits), North-South Seeds, and *Shubinak*. Each of these three attempted to follow the comparative advantage principle and promote a local product to the outside world. The idea here was that while subsistence farmers by themselves could not create an external market demand for their products but that, once such demand existed, the small farmers would be able to supply it.

[12] Approximately US$ 6.6 million using an average exchange rate of Pak Rupee 45 = $1 for the time period; of this amount, US$0.6 million was lent to women entrepreneurs.

This was a conscious attempt to create entities that would promote backwards and forwards linkages in the production process.[13]

Dry Fruit Project

Set up by the AKRSP in 1997 at an initial investment of PKR 4 million (US$ 97,500), the Dry Fruit Project (now renamed Mountain Fruits, MF) provides 'fair trade' apricots to the UK-based firm Tropical Wholefoods, which in turn sells it as an input to various 'fair trade' firms in the UK and the EU and markets ‘Hunza Apricots’ itself. MF is also marketing its own products (dried apricots and apples, as well as mulberries and cherries) in the rest of Pakistan and the AKRSP/MF brand carries considerable name recognition in Pakistan as a symbol of quality. MF was phenomenally successful and broke even within 18 months. Through a relentless emphasis on purchasing only the best quality fruit, the MF has caused farm-gate prices for its, for example, desired grade of apricots to double. The overall impact of the AKRSP's efforts here has been quite impressive as the price difference between the farm-gate price of the lowest grade of dried apricots (PKR 3-10 per kilogram) and the highest (PKR 20-45 per kilogram) is now substantial (Roomi *et al* 2002) and farmers are improving their fruit quality in order to earn the higher prices. Prior to this, the price differential was not enough to encourage farmers to improve fruit quality. However, despite the considerable increase in output marketed, from 8 metric tons in 1998 to 47 in 1999 (Roomi *et al* 2002), there are only an estimated 500 farmers selling to MF so in that sense its overall impact is relatively small in the NAs and most farmers do not benefit directly.

North South Seeds

[13] Although to the best of my knowledge this Hirschmanian terminology was not used within the AKRSP.

This was the AKRSP's venture into commercial agricultural seed production for the domestic Pakistani market, estimated at PKR 200 million (~US$ 4 million plus) in 1999 and growing at 14% p.a., with most of this demand being met by smuggled Indian seeds. North South Seeds was set up at a cost of PKR 60 million (US$ 0.94 million) in 1999 and immediately ran into severe quality control problems as the large number of small, usually illiterate, subsistence farmers it had to deal with made quality control extremely difficult.[14] North-South had to, at times, resort to using commercial farmers down-country to meet its contractual obligations. As of 2004, five years after its inception, North-South Seeds was nowhere close to breaking even financially. While successful commercial seed production is a very long term process, the difficulties experienced by North-South Seeds exemplify the difficulties inherent in successful commercialization in the NAs. However, this experience has greatly increased the farming expertise, production quality and income of the roughly 500 small farmers, half women, it contracts with for seed production. For example, while per capita income in NAs was ~PKR 10,000 (US$ 244) in 1997, the average farmer earned PKR 4,638 (~US$ 95) in sales to North South Seeds in 1999 and 96% of the contract growers wanted to expand sales to the firm (Roomi *et al* 2002).

<u>*Shubinak*</u>

Shu, or *patti*, is the extremely fine, very high quality local wool (akin to cashmere or *pashmina*) produced in Chitral, Pakistan. It has traditionally been used to make very expensive caps, shawls and coats and is usually hand-spun as a cottage-industry by women. The AKRSP decided to set

[14] From the personal knowledge of the author, some of the key quality control issues here were: keeping the seeds from being contaminated with those of other varieties, ensuring that seed production is done in disease-free soil, preventing animals from grazing in fields used for seed production (a vitally important issue in an environment where free grazing used to be the norm), etc.

up a new firm, *Shubinak,*[15] in an attempt to standardize and raise *shu* quality and market it abroad to cash in on the international *pashmina* craze of the 1990s. AKRSP's decision to become involved in *shu* marketing was in part a reaction to traders selling much lower-quality, usually machine-spun, down-country wool as *shu* and thus reducing the market price and demand for high-quality *shu*. With no comprehensive plan to defend traditional *shu*, it was feared that an important source of household income for village women would soon be destroyed.

Starting in 1999, the AKRSP invested over PKR 37.9 million (~US$ 0.6 million plus) in quality control and market creation for high quality *shu*. Among other measures, it instituted a four-year price support program for 'golden *shu'* (the highest grade) in order to give weavers an incentive to improve quality. The AKRSP also trained women in improved spinning techniques and subsidized equipment purchase.

While the international marketing efforts, undertaken at considerable cost, failed completely, AKRSP's insistence on standardization and quality control doubled the whole-sale price of 'golden *shu*' and created a larger domestic market for it. However, due to the extremely high cost of ‘golden *shu*,’ this market segment is still extremely small in Pakistan and most *shu* purchasers are price and not quality conscious.

In addition, the traditional marketing practices in Chitral are that weavers supply *shu* on a deferred payment basis to local middlemen who then sell the *shu,* again on credit, to retailers down-country. The highly informal nature of most of these transactions means that payments are usually greatly delayed and dealing with new purchasers/retailers is fraught with default risk: one deals with buyers and retailers one knows and trusts. This practice means that, perforce, the effective universe of producers, wholesalers and retailers is a very small one and economic

[15] Meaning literally spider or, here, weaver, in Chitrali.

transactions are correspondingly reduced. *Shubinak* made payment-upon-delivery to its weavers but could not insist upon this for its buyers. It therefore had considerable carry-over financing costs as well as legal and administrative costs in pursuing payment from its buyers (down country retailers). While *Shubinak* was successful from a quality-raising and wholesale price perspective, this is clearly not a sustainable enterprise from a purely financial perspective unless a new and expanded network of down-country retailers is possible.

3 Business Development Services (2003 on)

In 2003, following the major restructuring of its credit program, the AKRSP initiated the transition to the third phase of integrating the NAs economy into a market structure. In effect it decided to reduce its emphasis on encouraging microentrepreneurship--the transition from subsistence farming to commercial activities for its beneficiaries--to simply Business Development Activities (BDS). The AKRSP defines BDS as "any nonfinancial service provided to a business on either a formal or informal basis which adds value to the business" (Afzal 2006:301). That is, the AKRSP was no longer going to attempt to create markets where none existed before. It was simply going to facilitate the activities of existing market participants in improving output, reducing costs, and so on. This was, in effect, an admission of defeat and was, not uncoincidentally, linked to the setting up of a separate microfinance institution (the FMBL) to handle all AKRSP's savings and credit functions.

Since 2002 the AKRSP has assisted the Baltistan Gem Association (a non-AKRSP trade association) in both improving its mining methods and putting on a Gem Show in Islamabad in an effort to attract new buyers, bypass traditional down-country middlemen and so keep more of the value-added in the NAs. It has assisted the Chitral Association of Mountain Area Tourism (another non-AKRSP trade association) in improving its tourism marketing and internal quality controls. It has also assisted non-VO based apple and apricot marketing groups (i.e., individual farmers' associations not associated with the traditional AKRSP VO structure) in advertising, packaging, and so on, for their products.

However, old habits die hard and the AKRSP is still 'encouraging' the development of new entrepreneurial activity in the NAs. For example, it has encouraged recent college graduates to start new firms: the "*Apna Karobar* Scheme" (i.e., My Own Business) which selects and trains 20-25 young entrepreneurs each year, assists them in establishing their own businesses and arranges startup funding for them through the government-owned Small and Medium Enterprise Bank (Ismail and Hussain 2003:30).

IV Conclusion

Despite decades of effort and the expenditure of large amounts of financial and material resources, the AKRSP has not been able to create a market society in the NAs and use that to ensure a self-sustaining process of economic growth and development in the region. This is not an unsurprising outcome since the creation of a market society, much less an entrepreneurial culture, is the result of generations of socio-economic development. The transformation of subsistence farmers into microentrepreneurs was never going to be easy or, as it turns out, feasible.

While no doubt successful in increasing the standard of living and quality of life for the subsistence farmers of the NAs, a very poor part of a very poor country, the AKRSP failed in its efforts to create a market economy there as the private sector is still virtually nonexistent in the NAs. There are only an estimated 23,066 jobs in the private sector in the NAs for a population of over one million (Ismail and Hussain 2003:ix) and a labor force growing at 5% p.a. (Ismail and Hussain 2003:12). It is in this context that after evaluating two decades of AKRSP development efforts therein, the World Bank evaluation concluded that

> As has long been the case, the future for a significant proportion of the population does not lie within the NAC [i.e., Northern Areas and Chitral]. Support and assistance in employment information and in the migration process itself may be warranted. (World Bank 2002:35.)

It is thus clear that the AKRSP has not been able to turn the NAs into an economically viable part of Pakistan and it is here that the limits of its success have been reached.

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