

## Rural Credit Cooperatives Plans Restructuring:

Case Study Khorasan-e-Razavi Province, Iran

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**Abstract-** Credit cooperatives, play a crucial role in rural development process of Iran. This paper presents the process of rural credit cooperatives plans restructuring in Iran with particular emphasis on Khorasan Razavi province. The creation of the credit cooperative system in Iran resulted from some reasons, common to all Iran regions. Emphasis was given to the need for regional development and the difficulty for small depositors and loan demanders in having access to the national banks without sufficient resources and loan guaranties. The goals of the proposed Rural Finance Sector Restructuring and Development Program are to ensure sustainable access to institutional financial services for a majority of rural households.

**Keywords-** Iran; Rural Cooperatives; Credit; Restructuring

### I. INTRODUCTION

The term micro-credit has always been associated with very small loans (average size varies from country to country) to satisfy the credit needs of the poorer strata in communities. Informal financial services for the poor have and still are being provided by money lenders and traditional community level saving and loan associations. Only in the last thirty years have governments, donors and non-governmental organizations promoted these services to reduce poverty and inequality.

In the 1970s, experimental programs in Bangladesh, Brazil, and a few other countries extended very small loans to groups of poor women for investment in micro business. This type of micro enterprise credit was based on solidarity group lending in which every member of a group guaranteed the repayment of all members. The success of these programs further exposed the failure of early credit schemes which were provided as components of donor – supported area based development projects. In this field pioneering work by the Grameen Bank in Bangladesh, the Bangladesh Rural Advancement Committee (BRAC) and FINCA – style village banking in Latin America were instrumental in creating space for micro-credit to be treated as a sub – system in its own right within the overall financial sector of many countries.

Through the 1980s and 1990s, micro-credit programs throughout the world improved upon the original methodologies and challenged conventional wisdom about financing the poor. First, it showed that poor people, especially women, had excellent repayment rates among the better programs rates that were better than formal financial

sectors of most developing countries. Second, the poor were willing and able to pay interest rates that allowed micro-credit institution to start covering their costs.

Rural financial systems in many developing economies benefited also from a general decline of government interventions and lower market entry barriers for financial institutions. Especially saving and credit cooperatives and non-governmental organizations (NGOs), previously held back by often severe restrictions, can now more easily the field of rural financial intermediation.

### II. RURAL COOPERATIVE

Since the establishment of the first cooperative in 150 years ago, there has been a tremendous growth in developing cooperatives throughout the world. Based on the latest statistics, approximately 800 million people are members of cooperatives in over 100 countries [1]

More awareness and knowledge about the cooperative form of enterprise, as an option to conduct business, is widely needed by the people most likely to benefit from it [2].

Cooperatives can accelerate the process of development and participation of rural population in their activities. In many countries, agricultural cooperatives prove to be an important model of enterprise by which small farmers can organize and optimize limited resources to increase their income [3].

Agriculture is vital for rural economic development and an important source of business for rural financial institutions. Capital formation is generally recognized as a necessary condition of development. Efficient financial markets play a key role in capital formation [4,5].

With rural poverty accounting for 63 percent of poverty worldwide, the importance of making microfinance services available beyond city limits is clear. The rural poor constitute both the greatest unmet need and largest unserved market for microfinance services. Providing financial services to the rural poor can address problems associated with high levels of poverty, low levels of production, and rural-urban migration. The objectives in rural microfinance are to extend the frontier of sustainable microfinance beyond urban areas by overcoming cost barriers, mitigating risk, and exploring technological and methodological innovations. On the other hand, government efforts of targeting the poor through subsidized credit have not been successful in the past. Firstly, the cheap credit has leaked to the relatively richer rural households. Secondly, the subsidy dependence of these institutions required regular injection

of government and donor funds and these institutions could not become sustainable. Thirdly and most importantly, only a fraction of the credit could flow to the women poor who are the most deprived of the poor. Hence these institutions have not been successful both in terms of outreach and sustainability.

The demand for credit in rural areas arises from agricultural investment, consumption smoothing by households, and non farm investment. These components are reflected in the demand for credit to the extent that these requirements cannot be financed from farm savings. Farm savings consists of self financed investments, bank deposits, and cash holdings. But the credit situation faces several serious problems. First, the existing institutions delivering formal credit are facing a serious financial crisis and cannot be sustained. Second, as discussed earlier, the present rural finance system does not cover adequately the smallholders, who will be very important for future growth. Third, an increase in the growth rate of agriculture will increase the demand for credit. But while more rapid growth in agriculture raises the demand for credit, it will also raise incomes and thus the ability to self-finance. Even with this increase in own resources, the total demand is expected to be greater. Furthermore, capital-intensive strategies to enhance agricultural productivity will create additional demand for credit.

The world rural economy has changed considerably over the last couple of decades. Many countries are going through economic transitions that are changing the rural landscape and the opportunities for investment and development. In recent years, the extensive losses of rural financial institutions and farmers' increasing difficulties in getting loans have inspired people to reflect on the following questions. What are the real effects of government-subsidized microfinance loans provided by rural credit cooperatives (RCCs) and the poverty alleviation loans? What is the coverage of RCCs microfinance loans? Have such loans met the demands for credit of rural households? What is really needed in rural finance, an ample supply of funds or a good funding mechanism? Can the rural financial system meet the demands of rural economy in transition? Is the current supervisory framework for RCCs effective?

According to modern economists, the success of credit cooperatives results from two features of cooperatives: they can capitalize on superior information about borrowers and they can impose inexpensive but effective sanctions on defaulting borrowers. These characteristics permit cooperatives to lend to individuals that conventional banks would not want as customers and to tailor loan terms more closely to borrower's needs [6].

### III. RURAL CREDIT SOURCES IN IRAN

Agricultural credit plays an important role in agricultural development. Agricultural household models suggest that farm credit is not only necessitated by the limitations of self-finance, but also by uncertainty pertaining to the level of output and the time lag between inputs and output [7]. Recent studies show the growth rate

of investment in agriculture is less than other economic sector. Agricultural financing is one of the most important factors to develop rural areas in developing countries. Payment of bank credit is a way of financing. In fact, facilitation of access to credit can raise amount of productive investment. Credit has a crucial role for elimination of farmers' financial constraints to invest in farm activities, increasing productivity and improving technologies. Generally, credit accessibility is important for improvement of quality and quantity of farm products so, that it can increase farmers' income and avoid from rural migration. On the other hand, some policy makers believe that payment of credit with low interest rate to farmers can support them against some results of development policies that threat their welfare [8].

Like many developing countries, small enterprises and farmers in Iran suffer from a lack of access to capital. It is difficult for them to get credit from banks. The economic and agriculture diversity in the different regions of Iran require local and specialized insight into the unique problems attached to the different farming systems; livestock/poultry weight gain and cost of production standards; horticulture and field crop yield requirements; and above all, marketing and farm prices fluctuation.

Rural credit in Iran comes from two sources – formal and informal. The main sources of formal credit are the Agricultural Bank Limited, the Commercial Banks and domestic private banks. The formal lending institutions are regulated by the Central Bank of Iran that provides counter finance to the Agricultural Bank of Iran and other banks. The informal sector is highly heterogeneous in terms of the relationship between borrowers and lenders and can be grouped into many types. Friends and relatives as a group provide the bulk of credit in rural areas (others include landlords, shopkeepers, merchants, forward buyers). Informal lenders have limited loan portfolios and operate within narrow areas of influence. These formal and informal sources provide credit services that differ from each other in terms of duration and amount of loan, its use, interest rate and transaction costs.

### IV. COOPERATIVE SECTOR IN IRAN

The first Iranian cooperatives began their work in 1974, mainly in villages. The aim of establishing these cooperatives, which used to benefit from governmental supports, was to improve the welfare of post-land-reform farmers. After Islamic revolution, social justice was announced as being the first priority.

According to the Article 44 of the Iranian Constitution, the economy of Iran is to consist of three sectors: state, cooperative, and private; and is to be based on systematic and sound planning.

- The **state sector** is to include all large-scale industries, foreign trade, major minerals, banking, insurance, power generation, dams and large-scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads and the like; all these will be publicly owned and administered by the

State.

**Table I: Credit sources for rural household in Iran**

Sources	Number	Percentage	Volume (million Rials)	Percentage	
<b>Formal</b>	4622	80.3	6566	81.7	
Agricultural	By farmers	1480	25.7	3685.8	45.9
Bank	By cooperatives	1862	32.4	664.7	8.3
Commercial Banks		992	17.2	2202.1	27.4
Gharzolhasaneh Sandoogh <sup>a</sup>		288	5	13.7	0.1
<b>Informal</b>	1129	19.7	1468.2	18.3	
Local traders		104	1.8	14.9	0.2
Forward Purchasers		75	1.3	18.1	0.2
Friends and relatives		852	14.8	1415	17.61
Other		98	1.7	20.2	0.3
<b>Total</b>	5751	100	8034.5	100	

Source: Agricultural Bank

<sup>a</sup> Money loaned without interest

- The **cooperative sector** is to include cooperative companies and enterprises concerned with production and distribution, in urban and rural areas, in accordance with Islamic criteria.
- The **private sector** consists of those activities concerned with construction, agriculture, animal husbandry, industry, trade, and services that supplement the economic activities of the state and cooperative sectors.

A strict interpretation of the above has never been enforced in the Islamic Republic and the private sector has been able to play a much larger role than is outlined in the Constitution. In recent years, the role of the private sector has been further on the increase. Furthermore, an amendment of the article in 2004 has allowed 80 percent of state assets to be privatized (Note C, article 44 of Constitution). According to Article 44 of Islamic Constitution, cooperatives were and are the second most important economic sector of the country (next to public sector). Private sector is ranked as the third one. It seems that the major aim of supporting cooperative sector was limiting the process of wealth accumulation in the hands of a small group, but not by creating a dominant public sector. So Cooperatives seemed to be the third way between capitalism and socialism [9].

The main difference between cooperatives and the state sector is that the cooperatives use a more democratic system of governance in which there is no employer employee relationship. Cooperatives are widely active in the market, where there always exist competition and investment risks. The cooperative sector in Iran covers all kinds of socio-economic activities. The sector's activities are mainly aimed to boost production and export of goods and services.

#### A. Rural Cooperative Societies in Iran

In Iran 22.23 million people living in 65000 villages who directly or indirectly depend on agriculture to survive, while most of them are living under poverty line. Still Iranian rural economy is dominated by agricultural sector which accounts for 27% of GDP, 22.9% of employment opportunities, 82% of food supply and 35% of non-oil exports, plus considerable raw materials for industrial use. Thus, the rural economy has an important role in national economy. To establish a sustainable economy in rural areas, almost every village needs credit, clean seeds, infrastructure and guidance in crops and livestock production. They also need farm machinery, marketing facilities, cooperatives, water supplies, education and diverse economic activities [10].

The history of Iran shows that the first cooperative law in Iran was enacted in 1925, which was amended in 1948, in 1952, and then in June 1971. The rural cooperatives were created as apart of the Land Reform program, but they started to operate before the Land Reform implementation. These cooperatives were transformed into fully governmental organizations in other to take over the duties of landlords and Bunehs [11].

Rural cooperative societies were in practice the most accessible source of institutional credit available to peasants. These cooperative were supported to cover all the land reform beneficiaries. The number of cooperatives, however, increased slowly. There had been 8361 cooperatives serving about 30000 villages by the end of 1972. Some of these cooperatives existed only on paper and about half of the villages can be said not to have had cooperative societies. In 1972, it was decided to consolidate the societies and consequently their number decreased to 2717 in 1973. As a result, the members of 6000 dissolved cooperatives had to rely on the bigger cooperatives which were located in large villages. In some cases, for example, peasants in twenty different villages were members of one and the same society [12]. Considering the dispersion of villages in Iran and the communication difficulties, this might in practice have deprived some members of the benefits of the societies. This may partly explain the bitterness and objections of the members of smaller cooperatives toward such a plan from its early beginning [13].

The most important objectives and duties of Iran Rural Cooperatives are as follows:

- Development, linkage and transfer of data between the networks of member cooperatives
- Accurate identification of potentials and capabilities in the agriculture sector, including poultry, animal husbandry, wheat farming, horticulture, etc.
- Expansion of workshops and factories as well as conversion, packaging and export industries
- Accurate information dissemination to the network with regard to the purchase and sale as well as local, regional and international marketing of agricultural products
- Expansion of credit agencies for extending loans to

members.

- Marketing and sale of agricultural products such as onion, potatoes, cotton, saffron, barley, etc.
- Marketing and sale of horticultural products such as apple, pistachios, almonds, grape, raisins, plum, etc.
- Distribution of materials needed by the sector, for e.g. insecticides and chemical fertilizers
- Distribution of modified seeds
- Supply and distribution of essential goods and other imported products needed by members in rural areas plus distribution of such goods at convenience stores throughout the province
- Import of agricultural products
- Export of agricultural products
- Participation in international exhibitions to identify new markets for agricultural products
- Participation in specialized seminars and events
- Collection, classification, packaging, storage, conversion, transporting, purchase and sale of goods and products of members.

#### B. Rural Credit cooperatives in Iran

Although rural credit cooperatives in Iran are expected to play important roles as the basis of the rural finance, they cannot fulfill their function as expected and cannot transform themselves into organization of cooperative society. At Present, the major activity of the cooperative is to provide loans to their members. The loans are principally financed by the agricultural bank and a small share of them is provided out of the cooperatives' own capital and reserves. But these sources are not enough to meet peasants' credit needs. The demand of rural households for credits can be categorized into commercial demand and social welfare demand. The former may be met by formal or informal financial service providers and the latter by government agencies.

Some cooperative organizations' efforts have been directly involved in credit problems. They are for the purpose of enabling members to meet their basic needs. Their social responsibilities are to create communities where people can enjoy their villages by working together. Rural financial and credit funds have been favored by politicians and planners of agricultural affairs as effective institutions in providing financial and credit services which lead to expansion and development of rural and agricultural activities [14]. Recently, establishing rural credit funds have been viewed by majority of countries, especially the third world countries as a mean for securing needed capital and credit for rural producers [15]. The same holds true for Iran, in which establishing and expanding rural credit funds is accomplished by collecting small capitals of farmers and producers. This important accomplishment not only creates spirit of cooperation in rural areas, but also plays an important role in alleviating financial needs of rural people and also expansion of agricultural production activities [16].

Recently, Iran's government has played an important

facilitating role in promoting this reform process. It has assisted local organizations to establish rural credit cooperatives in a number of villages.

#### C. Laws and Regulations

The cooperative law (for rural cooperatives in Iran), enacted in 1971, officially recognizes indigenous saving and credit cooperatives as financial market intermediaries if they are locally registered. The purpose of enacting cooperative law should be to give a legal status to the cooperatives and facilitate their working. It should also ensure that cooperatives work as genuine bodies and in accordance to the universally accepted cooperative principles. The legal framework for cooperatives consists of the law, rules made under it and the bye-laws adopted by the members of cooperatives in accordance to the act and rules. This together makes up procedures and rules for the organization and work of cooperatives, and protect and preserve their cooperative character. The Cooperative Law thus should facilitate the working of cooperatives and should not curtail the autonomous working of cooperatives and change their basic character. The day-to-day working regulations should be included in the bye-laws.

The Cooperative Laws, as stated above, consists of a Cooperative Act, enacted by the legislature of the country; subsidiary to the Act, in some countries, rules framed by the Government; and bye-laws as adopted by the members and registered under the Act. In case of conflict among the three i.e. Act, Rules and Bye-Laws, the Act is supreme, followed by the Rules, and then Bye-Laws. The Act should include the basic provisions relating to the principles, membership, registration requirements, management pattern, arbitration, liquidation, etc. The best law is that which is simple and brief, which can be understood by the common man, and which does not need plethora of sub-rules. Working details should be left to the members, to be included in the bye-laws [17]. The important provisions of the law are examined under the following headings:

- Cooperative definitions, objects and cooperative principles
- Registration
- Membership
- Management
- Funds/Capital
- Facilities and Concessions
- Disputes
- Penalties
- Winding up
- Rule-making power

#### V. THE INVESTIGATED PROVINCE

Khorasan-e-Razavi, a province with an area of 128,420 sq k, i.e. 7.8% of Iran total area, is located in northeastern part of Iran. The population is 4.8 million, i.e. 6.8% of the total national population; with a density of 37.2 persons per sq m. This province shares the borderline in north and north east with Turkmenistan and in northern border with Afghanistan. Figure1 shows the location of Khorasan-e-

Razavi area. According to the results of the census in 2006, the population of Khorasan-e-Razavi province is 5536800, this province is one of the most populous province of Iran. About 3811800 persons live in cities and about 1725000 live in the villages. 86.18 percent, older than 6 years are educated. The rate of the educated persons is 90.36 percent in the cities and 77.08 percent in the villages.

According to the accomplished researches on applying the lands in Khorasan-e-Razavi, near 30 percent of the lands of this province have been allocated to water farming, gardening and dry farming. These regions are mainly located in the center, north and northwest and northeast. 6.1 percent of farms and 10.6 percent of gardens of the country are in Khorasan-e-Razavi. Total cultivated lands are 981488 hectares and gardens are 226796 hectares. There is too much variety of agricultural products in Khorasan-e-Razavi, the main agricultural products of the province consist of wheat, barley, sugar beet, cotton, tomato, potato, onion and summer crops. The most important crops consist of pistachio, grapes, cherry, apple, almond and pomegranate. It should be noted that Khorasan-e-Razavi produces a large quantity of Saffron and supply this unique product with highest quality for domestic and international markets.

#### A. Pilot program

The goals of the proposed Rural Finance Sector Restructuring and Development Program are to ensure sustainable access to institutional financial services for a majority of rural households. Specific objective is to support a sustainable financial cooperative system for providing affordable services, primarily to the middle and lower segments of the rural finance market for a significant income expansion impact. Increased financial intermediation will provide opportunities to clients to increase incomes and employment and improve their quality of life through access to strengthen and responsive financial cooperative system. It can be realized from fig. 2, in order to leading a successful financial system (crediting) for the investors as well as the welfare of their communities, the production stage must be followed by the Credit and saving stage, and then the Supply of inputs stage, and completed by the Marketing stage [18].

The credit cooperatives restructuring program initiated in 2005 in Khorasan-e-Razavi is important experiment to correct the serious mismatch between rural realities and financial sector reform and development. The main objectives of this pilot are to encourage financial innovations that suit local economic development and to establish a modern rural finance system to meet the financial demands of localities, rural industries and households with varying income levels.



Figure 1: Khorasan-e-Razavi Province

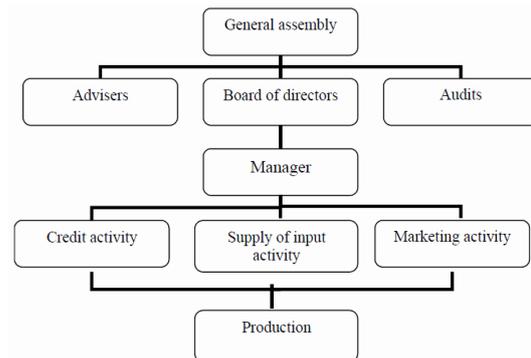


Figure 2: Structure of Rural Cooperatives in Iran

Under the pilot program, 189 village RCCs in Khorasan-e-Razavi were consolidated in accordance with the eighth chapter of 1350 cooperative rules. Different economic and market structures have resulted in a variety of demands for financial services from different regions and different religion (Shiism and Sunnites). That is, different types of financial institutions or service providers that suit local socio-economic and geographical situation should be adopted. In Sunnites regions, demand and supply for rural finance mainly different from Shiism regions. The most financial demand is for protecting livelihoods generated by uncertainties in agricultural production. Different regions have different problems. A comparative position of the deposit portfolio of the credit units as on 2005, 2006, 2007, 2008 and 2009 is given in the Table 2, fig. 3 and fig. 4.

Table II: Outreach of the credit cooperatives

Years	Period	Number of credit units	Deposit	Number of depositor
2005	June	74	10.4	29496
	September	71	12.1	32788
	December	76	14	34001
2006	March	86	15.1	39143
	June	97	18.4	43274
	September	104	24.6	46772
	December	111	29.3	51740
2007	March	126	32.1	56929
	June	133	35.6	60257
	September	149	47.7	66065
	December	159	55.6	70381

	March	163	56.9	74835
2008	June	171	68.8	75424
	September	175	72.7	83013
	December	182	73.6	88359
	March	186	75.1	93155
2009	June	189	89.1	94432

Source: Rural Cooperative Organization (Khorasan-e-Razavi)

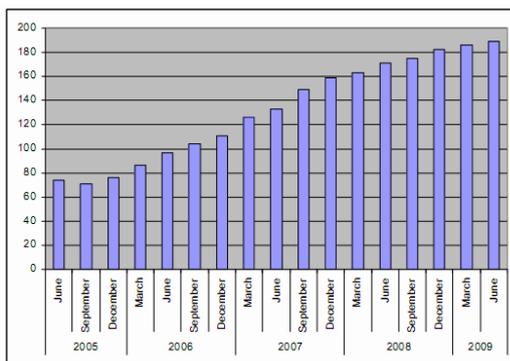


Figure 3: Number of Credit Units in Rural Cooperatives (2005-2009)

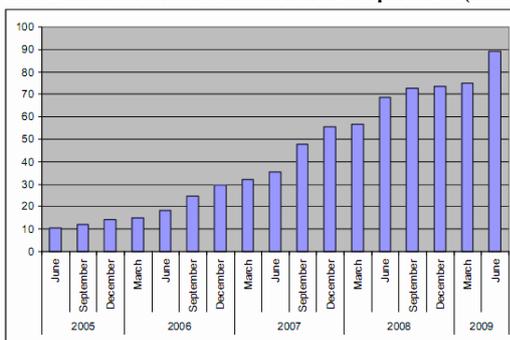


Figure 4: Deposit Growth (2005-2009)

## VI. CONCLUSION

Cooperatives in Iran particularly in the rural areas have up till now been enjoying Govt. support and protection in the shape of subscription to share capital, preference in the matter of grant of licenses, reservation of certain products for co-ops, etc. These props are being gradually withdrawn and co-ops have to face competition not only from the private sector but also from the NGOs in micro finance and poverty alleviation activity and from Multinational Corporations in the field of agricultural and industrial production and consumer retail trade. On the other hand, the relationship between a well-developed financial sector and economic growth and poverty alleviation is well-established. The relationship is not merely one of correlation, but causal. There are robust evidences that countries with better developed financial systems experience faster reductions in income inequality and faster rates of poverty alleviation. Thus the development of an efficient financial system should be at the center of a pro-poor development strategy. Therefore, so many plans and restructuring programs are being implemented for the well

being of credit cooperatives within the past 3-4 years.

In order to build a diversified and competitive rural financial market, there is a need to broadly rethink rural financial reform and development strategies. The restructuring program would require the government to inject new capital. The government is increasingly demonstrating its recognition of the importance of better understanding the lessons of past reforms, and it willingness to take a more comprehensive approach to future reforms.

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