SHARIAH FINANCING FOR FARMERS POVERTY REDUCTION

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Abstract

The agricultural sector issues remains important, both from strategic and pragmatic sides. From the strategic side, the contribution to GDP and labor absorption in this sector is still significant. While at the pragmatic side, contrary to earlier, the poverty rate of economic actors at the sector did not experience significant improvement. Farmer’s poverty alleviation efforts, as if to see a thick wall. In the era of oil boom of the past, subsidies be the paradigm taken by government. However, because of government budget constraints, and also the absence of the private sectors role, the efforts being failed. Shariah banking have a great obligation to face this huge potential demand. Because of poor farmers was a part of the largest Islamic community itself and the maqasid Shari’ah philosophy put the protection of mankind from poverty and indigence as one of the main objectives. Nevertheless, major barriers to technical and economic, made sharia banking still not present in those efforts. Need a new paradigm which using a comprehensive approach and involve actively participation of all parties to realize those goals. To that end, this paper will try to offer that new paradigm.

Keywords: Microcredit, Farmers, Shariah, Poverty

INTRODUCTION

Agriculture is the fundamental building blocks of almost 16% of national GDP of Indonesia, accounted for about 60% of exports and employs nearly 50 % of the workforce (Central Statistical Biro of Republic of Indonesia, 2010). The government realizes that a significant improvement in meeting the financing needs of this sector is a prerequisite to success programs aimed at removing farmers from the bondage of poverty and strengthen national food self-sufficiency for the needs of society in the future. Various efforts have been taken by the government to achieve the intended purpose. Demand approach to provide ease of fare input agricultural production and infrastructure facilities to farmers through provision of technical assistance for capacity building and productivity of the agricultural sector, as supply-side approach, has been carried out directly by the government as one of the important actors of the economy. In addition, as disclosure of private investment flows, various incentives and support for parties (stakeholders) other in a common purpose is also intensively conducted.

However, every effort was still encountering steep road. Hundreds of trillions state money for various types of farm subsidy programs, the annual time to implement various programs, but results are still far from the truth. Farmers, the majority of rural people is the most marginalized communities in the country until today (Central Statistical Biro of Republic of Indonesia, 2010). In high risk inherent in this sector, lack of program coordination among
stakeholders, as well as lack of knowledge of financing models that fit the requirements and the business cycles of agriculture and its derivatives (on and off-farm) is a common phenomenon in this country. This is a great obligations for the government today. Needed a new paradigm of poverty alleviation of farmers. That the farmer should be seen as a major economic entity and potentially greater than the economic side.

Special of the capital side, if the farmer has always been viewed as a group of people receiving cheap credit and subsidized because of their poverty, so that credit will only available in government coffers as thick then it is time farmers were introduced to specialized financial institutions that can always meet their needs appropriate, accurate and appropriate amount. Therefore, need to be a synergistic cooperation between various stakeholders in responding to the implementation of this new paradigm. Hopefully, Shari’ah banking also plays an important role in this great project.

This paper is a theoretical study that tries to provide a meeting point between demand for and supply availability of financing in the agricultural sector and some strategies to make it run properly based on the review of existing literature. The first section will review research on the several myths and facts about of the micro business sector commonly and agricultural sector particularly. It’s will include the description of several stereotype pf farmers and it’s agriculture’s sector put on them by another economics actor especially financial industries and at a meanwhile, also describe it’s very huge potential and effective demand for financial access. The second part will discuss about the government role through several policy which made in order to overcome the farmers’ poverty classified as an old paradigm. The third section, will describe about the possibility between microfinance and Islamic bank at concept matching to overcome the poverty issue. The fourth section, describe agricultural sector financing of products shariah and the concluding section will discuss about alternate paradigm where some noodles precondition for micro credit for agricultural sector shariah are exist so the poverty alleviation of the farmers program can be run well.

Farmers Poverty : Myths Vs Facts

There are a number of publications and topics of rural finance, more specifically, agricultural credit. Some discuss the approach used during the last decade, what works and where the failure occurred. Others present a new approach developed in response to a recognized failure of the past and try to incorporate the lessons for the provision of services well in the future. Others still provide useful guidance or advice for practitioners involved in serving rural communities with agricultural credit and other financial products.

However, a variety of earlier studies have linked some of the same conclusions in the rural agricultural sector, namely:

1. Economic development of rural areas lags behind urban
2. Rural areas have not been well served by the microfinance industry and also
has not been effectively reached by the financial services during the last decade primarily because institutions and donors focused on the urban

3. Financial institutions that provide services to rural communities face significant challenges and real;

4. Agricultural lending is inherently risky, and difficult to be effective because of geographic dispersion, market linkages are weak, higher costs, lack of extension support services and the inherent risks;

As the above note, there are reasons why bank reluctant to give financing to the poor, one of the important elements is trust. The basis of trust depends on two critical elements: first is the applicant’s reputation as a person of honor; and second is the availability of enough capital or collateral against which claims can be made in case of default (Dusuki, Asyraf Wajdi, 2008). The essence of conventional profit-maximization banks as financial intermediaries providing financial services to people hinge upon two elements. As formal lenders, risk-averse banks would only willing to lend if these two elements serving as a basis of trust exist in their reciprocal relationship with clients (as borrowers). For instance, the bank is able to assess the reputation of borrowers based on bank’s intimate knowledge embedded in the clients personal accounts as well as other documented history of past borrower behavior. At the same time, the clients have material value such as properties or any valuable asset serving as collateral to pledge against risk. Another element that taking into consideration by the bank is “too poor” to save. Those elements make the poor has difficulty to access the credit from the bank.

In many developing countries, risk management techniques are underdeveloped or insufficient for institutions to efficiently lend to activities in the agricultural sector. Information on borrowers credit histories is rarely available, resulting in information asymmetries that make accurate credit risk assessment difficult. In addition, while agricultural client’s major assets are production and land, it is often difficult for banks to use these as collateral, and particularly difficult to foreclose on land in case of default. Compounding this lack of traditional collateral is the presence of a high degree of covariate risk, in particular market price risk and weather risk. Banks lending to agricultural clients know that agricultural and rural revenues easily drop below break-even levels due to extreme weather events and price falls, which result in defaults and higher loan loss provisions, thereby making lending to agribusiness unprofitable.

The second major constraint in agricultural lending, high transaction and supervisory costs, is due to the particular risk, nature, and characteristics of the rural sector. In all financial markets, there is a trade-off between minimizing loan default and supervisory costs, but the nature of agricultural lending, especially through microfinance institutions, makes transaction costs and supervision costs disproportionately high relative to its urban counterpart. The small size of seasonal agricultural credit results in high due diligence
costs per loan. The large geographical spread of customers, coupled with poor transportation and communication infrastructure, increase supervisory costs for financial institutions and compliance costs for customers. In addition, banks in rural areas find it difficult to attract qualified and trained loan officers.

High levels of risk and transaction and supervisory costs contribute to the absence of functioning rural financial markets and institutions in many countries. This lack of adequate financial services can also be partially attributed to the rapid disengagement of government as the primary source of agricultural lending in many post liberalization economies. When public sector banking institutions began pulling out of lending or changing their nature of operations, the private sector was expected to take over and offer credit in rural areas. But in many developing countries this space has not yet been filled.

Financial market efficiency is also often hampered by government regulation. For example, interest rate caps and other restrictive lending policies (even policies designed to direct lending into the rural sector) typically result in credit rationing to the largest, wealthiest, and most established farmers, and reduced availability of credit for the poorest farmers, such as smallholders or day wage labourers. These factors combine to limit the supply of rural financial service in general, and agricultural finance in particular. Agricultural borrowers in rural areas adjust by resorting to informal credit, reduction of farm inputs, suboptimal production techniques, and borrowing from family and friends. This limits the investment in farm equipment and capital as well as other agricultural assets such as oxen.

In addition, producers concentrate on low-risk, low-return activities because they cannot access the start-up capital required and cannot transfer systemic risks.

Table 1. Limitation in Extending Agricultural Finance From the Supply and Demand Perspective

<table>
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<tr>
<th>Financiers: The Supply Side</th>
<th>Agricultural Enterprises: The Demand Side</th>
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<tbody>
<tr>
<td>Small size average farm, low population density, higher loan servicing costs due to limited volumes and high information costs.</td>
<td>Agribusinesses suffer from poor, insufficient collateral and non enforceability of security due to lack of land and property rights, high costs, and lengthy or lacking registration and foreclosure processes.</td>
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<tr>
<td>Lack of collateral or adequate security.</td>
<td>Low affordability for farmers of market interest rates and higher margins (up to 2% higher than standard SME loans) that reflect the risk adequately.</td>
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<tr>
<td>Lack of technical knowledge at the bank level to evaluate and analyze the creditworthiness of agribusinesses.</td>
<td>Insufficient cash flow planning; farms are not obliged to keep accounts or financial statements; cash flows are hard to assess when clients sell directly to consumers.</td>
</tr>
<tr>
<td>No specialized product offered by the financial intermediaries to better meet the financing need of the agricultural sector: rural sector requires preharvest financing to buy inputs that can only be repaid after harvest and show much more uneven cash flows than urban borrowers, leading to repayment in less frequent instalments, which increases the risk and monitoring costs for financiers.</td>
<td>Repayment schedules are often difficult for the clients to meet; standard repayment schedules are not adapted to seasonality of the business.</td>
</tr>
<tr>
<td>No branches or limited network in rural areas, thus difficulties to reach and market to farms.</td>
<td>Lack of legal education at the farmers’ level</td>
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Risk correlation when lending to farms: all borrowers are affected by the same risk, such as low market prices and reduced yield due to weather. Farms are often successors of cooperatives, which are rather complex to deal with.

Underdeveloped communication and transportation infrastructure. Lack of initiative and articulated demand for finance by agribusinesses, especially in primary agriculture.

Source: Langenbucher, 2005

But even so, the literature also shows that during the last few years, donors have begun to express new interest in the rural sector and agriculture finance. This is partly due to repeated commitment to international poverty reduction and the recognition that the majority of the world’s poor live in rural areas. Manfred Zeller identified two main motivations are renewed interests on the Development of rural institutions and financial sector (Zeller, Manfred. 2003):

1. Agricultural sector remains the most important economic sectors, particularly for the poor in many developing countries;
2. Improved financial markets will accelerate agricultural growth and rural areas, leading to greater economic growth and reduced poverty

Over the last several decades, despite a lack of focus of donor community, various organizations have been working in rural areas to reduce poverty or provide access to some form of financial services. In fact, there are a number of examples used in the literature are often successful interventions in rural and agricultural finance. In particular, the BRI in Indonesia, Calpia in El Salvador, and Prodem in Bolivia among several others described as a successful provider of agricultural credit (in addition to other services) for the rural population. In addition, ROSCAS, SACCOS, self-help groups, in the form of credit programs, agricultural banks and other micro and rural finance institutions around the world continue to provide access to financial services targeted at rural populations with varying degrees of success.

Role of Government

The “old rural finance paradigm” of the 1960s and 1970s was based on concern for increasing rural lending, especially in agriculture, on the assumption that more credit would lead to agricultural development. This paradigm led governments and donor agencies to focus on market intervention, making up for the lack of credit by lending on favorable terms (with subsidized interest rates, without guarantees, etc.). The results were not encouraging: no agricultural development process resulted, and the credit programs proved costly for the government and unsustainable over time. Many of these lending programs merely served the government’s political ends and/or underestimated the difficulties and risks implicit in their implementation.

This paradigm had various consequences, according to Nagarajan and Meyer (Nagarajan, Geetha and Richard L. Meyer, 2005). The institutions were unsustainable because of subsidized interest rates (which also made them unattractive to savers); there was an
increase in unproductive loans because of low-cost lending for relatively unprofitable investments; portfolios were concentrated in the hands of the wealthiest borrowers, even though most programs had social objectives; subsidized credit encouraged farmers to choose unprofitable crops; a culture of non-repayment was fostered because debts were forgiven or politicians promised to forgive them; and the existence of unsustainable, highly subsidized intermediaries discouraged the development of private intermediaries.

The second paradigm emerged with the “microfinance revolution” that began in the 1970s, especially with the activities of non-financial entities, such as NGOs, or financial institutions closely tied to poor sectors and their organizations (cooperatives, mutual associations, etc.). Financial institutions and products were developed for customers who had traditionally been ignored by the financial system (especially “poor” clients). Increasing attention was paid to the functioning of informal markets, and value was placed on access to information and a close relationship between lender and borrower, while there was innovation in the type of products and services and in the technology for delivering loans and recovering debts. Above all, it was demonstrated that financial services can be offered on a small scale and under conditions traditionally considered adverse (without real guarantees, informal, etc.), and that this can be done by private institutions (for profit or non-profit) that are financially sound and profitable. The success of microfinance is that it has shown how to address and overcome the financial markets failures. It is true that microfinance does not serve all of the segments that are left out of the traditional financial system, and that it tends to focus on providing credit, which also tends to be short term and for small amounts. Nevertheless, as microfinance intermediaries have become more solidly established and heterogeneous, new technologies, products and services have been developed and debate has arisen about the earlier paradigms and the usefulness of the progress that has been made in understanding and rethinking rural finance. It must be noted, however, that microfinance has been less successful in offering agricultural credit.

In Latin America, the inadequate development of rural finance and rural markets in general remains one of the central, recurring themes in discussion of public policy for promoting development and eliminating poverty. Rural financial markets remain sluggish and have been unable to establish a broad financial system that meets the needs of rural dwellers, especially low-income residents. Various public policies and private sector actions have been implemented in the region in an effort to expand the scope and depth of these financial services, both by promoting rural development (efforts by Ministries of Agriculture, for example) and through initiatives aimed at bolstering countries’ financial systems (efforts by Banking Superintendence’s, state banks, etc.). Most have met with only modest success in serving new rural clientele segments, with heterogeneous
results in terms of the sustainability and efficiency of the financial entities.

The financial limitations that rural farmers and non-farmers face prevent or restrict them from engaging in more profitable economic activities and increase their vulnerability and that of their enterprises. This is especially true because of lack of insurance markets and/or limited informal mutual insurance systems. As a result, rural dwellers make decisions that are biased toward minimizing risk instead of maximizing return. Since the late 1980s and early 1990s, analyses, recommendations and proposals for actions aimed at the development and enhanced operation of rural financial markets have been framed, at least in Latin America, within the context of financial liberalization and/or, more generally, economic structural adjustment.

As theory predicts and practice has shown, public-sector financial institutions have not achieved good results as promoters of financial markets or as substitutes for them (as financiers for rural areas). Most of these entities have been inefficient, non-competitive, discretionary, and subject to political intervention and corruption, and in some cases the expense of maintaining them has put a heavy strain on public coffers. But the absence or withdrawal of public entities from rural financial systems has also failed to expand the private supply of funds for rural areas. The private sector’s service of this market is sporadic and limited, and tends to target the wealthier sectors. Neither countries that chose to eliminate their development banks nor those that changed the banks’ approach managed to achieve widespread service to rural clients. Even in cases where the private sector responded positively to development banks’ withdrawal, the response has been inadequate, and in many cases has not even managed to reach the clients who were served by the development banks. The reasons for the limited private response lie in the well-known failures of rural financial markets and in government shortcomings. In addition, financial markets that are more profitable and attractive (less risky) are developing rapidly in low-and middle income urban areas.

The current situation also points to significant changes in rural markets. In many countries in Latin America, there has been an opening of land markets, changes in the state’s role in factor (especially technical assistance) and product markets, and renewed interest by academics, and especially from policy makers and the public sector, in development finance institutions. More than 30 development finance institutions currently operate in Latin America, providing agricultural credit. It is interesting to note that these institutions take varied forms; unlike the old, traditional agricultural banks of the 1970s, most are profitable, and have multi-sectoral approach. So while a conceptual debate persists about the relevance of creating or maintaining public finance institutions, the discussion in Latin America no longer seems to be about whether or not public banks or public institutions serving the rural sector should exist. It is clear that they do exist, they are important and they are here to stay.
Microfinance and Islamic Bank

Microfinance means “programme that extend small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families” (Mizanur, M. Rahman, 2010). Microfinance is one of a powerful tool and instrument that can alleviate poverty. It means provision of financial services to poor and low-income people whose low economic standing excludes them from formal financial system to access such as, credit, venture capital, savings, insurance, remittance is provided on a micro-scale enabling participation of those with severely limited financial means. The provision of financial services to the poor helps to increase household income and economic security build assets and reduce vulnerability; creates demand for other goods and services (especially nutrition, education, and health care); and stimulates local economies (Obaidillah, Mohammad, 2008).

The microfinance initiatives are become more popular today in many Islamic countries although previously it was dominated by conventional system. Many articles and paper are written regarding the idea or model on how to Islamize the microfinance. Microfinance refers to making small loans available to poor people (especially those traditionally excluded from financial services) through programmes designed specifically to meet their particular needs and circumstances. Microfinance also known as programme that extends small loans to very poor people for self-employment projects that generate income in allowing them to take care of themselves and their families. One of the clearest frameworks of microfinance has been put forward by Prof. Dr. H. D. Seibel who defines microfinance as follows: “A sector of formal and non-formal financial institutions providing micro saving, microcredit and micro insurance services to the micro economy, thereby allocating scarce resources to micro investments with the highest rates of return. In a narrow sense, microfinance institutions are small local financial institutions. In a wider sense, they may also comprise national or regional banks with microfinance services for small savers and borrowers.

Among the features of microfinance is the disbursement of small size loan to the recipients that are normally micro entrepreneurs and the poor. It means that the loans are giving away to them with the purpose of generating income from new project or business expansion. Normally, the terms and conditions of the loan are easy to understand and very flexible due to their circumstances. It is provided for short term financing and repayments can be made on a weekly or longer basis. The procedures and processes of loan disbursements are normally fast and easy. Additional capital can also be given after the full settlement of the previous loan. Microfinance institutions provide to the entrepreneurial poor financial services that are tailored to their needs and conditions. Good microfinance programs are characterized by small, usually short-term loans; streamlined, simplified borrower and investment appraisal; quick disbursement of repeat loans after timely repayment; and convenient location and
timing of services (Obaidillah, Mohammad, 2008).

The primary mission of microfinance is, therefore to help poor people in assisting themselves to become economically independent (M. Rahman Mizanur, 2010). There are several writers that mentioned in their paper regarding the foremost objective of microfinance institutions which is to alleviate poverty. It is widely believed that microfinance programmes will raise incomes and broaden financial markets by providing credit, among other services, to small scale entrepreneurs. Credit or loan is given for self employment and for financing additional income generating activities. As currently, microfinance has emerged as an important instrument to help a large number of “unbankable” members of society, as a tool to help reduce poverty and encourage economic growth in neglected parts of the world.

Most of the microfinance institutions have non-Islamic characteristics mainly because their interest-based of financing. Conventional microfinance institutions (MFIs) have often been criticized for charging the poor exorbitant interest rates and fees. This is largely due to the higher transaction costs incurred, including the provision of services such as monitoring, advice and health insurance. Yet, there are not many Islamic microfinance institutions and they exist only in a few countries. These institutions largely use the group based lending format of the conventional Microfinance Institutions and adapted Islamic principles and values.

While utilizing various Islamic modes of financing, they usually encounter difficulty in obtaining funds from external sources. While some funds are available from government agencies, they are often subjected to terms and conditions that are not in compliance with Islamic principles. There are inadequacy number of Islamic Microfinance and only a number of shari‘ah compliant microfinance schemes, notably those operated by Hodeibah microfinance program in Yemen, the UNDP Murabahah based microfinance initiatives at Jabal al-Hoss in Syria, Qardhul Hasan based microfinance scheme offered by Yayasan Tekun in Malaysia, various schemes offered by Bank Rakyat Indonesia, and Bank Islam Bangladesh (M. Rahman Mizanur, 2010). Here is some of the overview of Islamic microfinance in several developed countries especially in South Asia and Southeast Asia from Islamic Microfinance Report (2009). In Pakistan, apart from the banks that provide microfinance services, there are some others Islamic microfinance institutions name as Akhuwat and Islamic Relief which based on qard hasan and murabahah financing. Pakistan has developed a unique mosque-centred structure. There is no funding from international donors or financial institutions. All activities revolve around the mosques and involve close interaction with the community.

Meanwhile, in Bangladesh, as the first countries to adopt microfinance, they used murabahah and bai‘muajjal based on the lending principles as their financing instruments.

The Grameen system dominates the market in Bangladesh, where it has been widely imitated by a range of large and small MFOs. The system was pioneered by
Professor Yunus in 1976, and has grown very rapidly since. In Indonesia, they maintain a dual conventional/Islamic micro banking system, which includes both conventional rural banks (Bank Perkreditan Rakyat or BPRs) and Shari’a-compliant rural banks (Bank Perkreditan Rakyat Syariah or BPRSs). Each BPRS has a Shari’a board to monitor the conformity of products to Islamic principles. In contrast with many single-product Islamic microfinance programmes in other countries, the financing portfolios of Indonesian IMFIs are reasonably balanced with an array of products based on murabaha, musharaka, mudaraba, ijarah and qard al-hasan. However, Malaysia has established several organisations under the aegis of government agencies to provide microfinance to small- and medium-sized enterprises using a wide range of Islamic financial products. In addition to financial institutions, efforts have also been made to diversify sources of loans for micro-enterprises and the poor, which includes Amanah Ikhtiar Malaysia and Islamic pawn broking (Ar Rahnu).

**Shariah Financing Modes of the Agricultural Sector**

Conceputal framework of Islamic finance is a sketch of a financial system where there is a real exchange in the form of goods or services or investments made through a profitable business. An important feature commonly used in Islamic finance transactions are given below.

**The trade-based modes (Based Trade Financing)**

Trade-based financing means providing financing through trade in goods and commodities. In this model, an IBI (Islamic Institutions Bank) acting as a trader and seller goods after buying the required items from open market/vendor/supplier, either directly or through an agent, upon customer request. IBI should be proactive in dealing with this type of financing and ensure that all act in fact describes the role of IBI as a trader of goods rather than just borrowing money. IBI should ensure its involvement in the subject of trade and exchange of goods/commodities through particular ways, such as the actual exchange of goods/commodities, taking possession of goods, has the subject goods/commodities and pricing and subjects that are sold appropriately. Several major types of finance with trade financing based are:

**Rental Based Modes of Financing: (Based on Model Lease Financing)**

In the mode based on the lease financing, IBI make a purchase of assets and transfer it to the customer assets under lease.

**Participatory Modes of Financing:**

Participatory financing based on the basic theme of participation in profit and loss. In the participatory financing, IBI provides funding for activities and are entitled to share profits or loss of business in accordance with the terms and conditions agreed upon. Agriculture broadly classified into sectors and non-crop plants. These two sectors are quite different in terms of financing needs and cash flow. IBI is involved in agriculture financing for both sectors. The details are as under.
Crop Sector (Sector Plant)

Financing for raising crops or horticulture by the farming communities of plants classified in the credit sector. Banks provide credit facilities crops/ agricultural sector to (i) financing of production inputs for the purchase of raw materials or working capital, and (ii) development of financing for equipment purchases or long-term investments at the farm.

Non-Crop Sector (Sector Non-Plant)

Funding for non-crop agricultural activities such as livestock, fishery, poultry, sericulture, apiculture, etc., are classified as non-crop sector credit. Bank provides financing to farmers to meet the financing needs of production and development in this category.

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<th>No</th>
<th>Purpose</th>
<th>Suggested Financing Mode</th>
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<td>1.</td>
<td>Purchase of inputs for crop production ie seeds, fertilizers, insecticides, sprayers manual etc. Poultry farms, including the purchase of feed, birds/day old chickens, feed raw materials, vaccinations, vitamins and medicines for poultry, sawdust, wood, coal, water filter equipment for poultry feed, Dairy cattle ranch that includes the purchase and planting of fodder and feed grinders, tokas, feed mixing machinery or container of milk or feed, vaccinations, vitamins and other medicines for animals Utensils; food animals, calf feeders, bracelets, rope/chain mail, etc. Fish farms purchases of fuel, rations and ice, packing/processing, cleaning supplies needed for the export of fish. For consumable items to heal and drying, insulated box Procurement, purchasing fish crates and plastic baskets.</td>
<td>Murabaha/Musawamah/Greetings/Muzara'a In a Murabaha and Musawamah, Banking Institutions (IBI) to buy these inputs from the market and sold to farmers at a certain price on a cost + profit. Preferably, this should be buying and selling right away where IBI make purchases from the open market and sell them to customers. This can be done through arrangements with suppliers of inputs. In the event of difficulties in direct sales and purchases, contract agents (representatives) can be created in which farmers (or others) will act as an agent of IBI to purchase the necessary goods. Regards Since this is the cost incurred in the course of production and the IBI may probably not be able to afford it directly, therefore, one possible model is Salam. In this mode, the IBI to buy the output to be delivered in the future with full payment according to the price at this point that can be used by farmers to meet its financing needs.</td>
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<tr>
<td>2.</td>
<td>Maintenance of agriculture, machinery, application and other working capital, cost of labor, water, the cost of other needs</td>
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Payment of working capital is usually associated with the cycle of planting and be mature about harvesting the plants. The main purpose is to finance working capital financing for the purchase of seeds, fertilizers, pesticides, labour, electricity, water, etc.
**Term Financing**

Financing to meet the financial needs in the medium to long term for both types of farmers' agricultural activities, both crop and non-plants, classified in the main long. Goals term financing within the framework of term financing is financing for the purchase of fixed assets ie machinery, equipment, tractors, van, etc. for use by farmers. It also includes financing for the construction of warehouses, farms, hatcheries and other investments on agricultural land by farmers. Mapping the various needs of agricultural credit requirements in various models of financing according to Shariah is recommended given in the following table.

<table>
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<tr>
<th>No</th>
<th>Purpose</th>
<th>Suggested Financing Mode</th>
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<tbody>
<tr>
<td>1</td>
<td>Agricultural Mechanization of farm land purchase, implementation, namely equipment trailers &amp; thresher, boom sprayers, plows, cultivators, drills, rotavators, diggers, cotton picker, press machines to create a crate, a machine for wheat straw and dry feed, plows, potato plantations, sugarcane plantations, reaper harvest crops of wheat and paddy power of movement itself.</td>
<td>Murabaha/Ijara/Diminishing Musharaka (DM) Financing for the various fittings may be given based on Murabaha (for small appliances/light or short-term pemb or Ijarah/DM for large equipment/heavy or long-term pemb). IBI, in the case of Murabaha to the purchase of equipment from the market and sold to farmers based on cost + profit. In the case of Ijarah, IBI acquire the necessary assets and leased to farmers. Ownership remains in the IBI is also associated with the risks and benefits. In the case of DM, IBI and farmers participate in the ownership of assets is needed. Farmers contribute to a certain% of the total cost of equipment and the remainder will be paid by the IBI. then sold its majority deni part until they run out to the farmers. Both parties share the risk of a pro rata basis.</td>
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<tr>
<td>2</td>
<td>Financing Transportation includes: the purchase of refrigeration vans, refrigeration of agricultural products, motorcycles for dairy farmer, small pickups, trucks and mini-chillers operators, etc.</td>
<td>IBI acquire the necessary assets and leased to farmers. Ownership remains in the IBI is also associated with the risks and benefits. In the case of DM, IBI and farmers participate in the ownership of assets is needed. Farmers contribute to a certain% of the total cost of equipment and the remainder will be paid by the IBI. then sold its majority deni part until they run out to the farmers. Both parties share the risk of a pro rata basis. Murabaha can also be used for this asset, in this case IBI purchase the necessary equipment from the market and sold to farmers on the basis of cost + profit.</td>
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<tr>
<td>3</td>
<td>Livestock financing include: Purchase of an adult cow or buffalo milk producer, the replacement of existing water buffalo or cow, the purchase of a young buffalo, cattle, sheep and goats for maintenance for meat production, cold storage tank milk, milk and meat refrigerated storage and refrigerated containers, vehicle distribution such as motorcycles, pick-ups. Development of water sources, warehouses, water tanks, water pumps, tube wells, the formation of the abattoir (RPH)</td>
<td>Financing for the various fittings may be given based on Murabaha (for small appliances/light or short-term pemb or Ijarah/DM for large equipment/heavy or long-term pemb). IBI, in the case of Murabaha to the purchase of equipment from the market and sold to farmers based on cost + profit. In the case of DM, IBI and farmers participate in the ownership of assets is needed, farmers are contributing in a certain% of the total price and the rest will be paid by the IBI. In the case of Istisna financing for assets (excluding livestock) IBI will be a seller/producer of the necessary assets assets (buildings, warehouses, etc.) and may appoint a builder/suppliers to build/provide the assets needed for onward sale to farmers.</td>
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*Source: State Bank of Pakistan, Guidelines on Islamic Financing for Agriculture, Islamabad, 2008*
New Paradigm

Exposure above provides an overview enough we will be a chance meeting of demand and supply of micro-patterned Shariah financing for poverty reduction objectives of the farmers. However, of demand and supply that is not managed properly will make all efforts were in vain as they are on a variety of previous experiences. In addition, the good name of Islam as a religion of anti-poverty and Islamic bank itself, would be a big gamble here.

Some of the preconditions necessary for all stakeholders supporting this program, both at the household level farmers themselves, the environment and the government, so this program can be realized and achieve its objectives. At the micro level, an institution that embodies the farmers is a crucial requirement. In the context of agribusiness systems, in addition to sub-system on-farm (cultivation) and sub-system off-farm (both in the provision of inputs upstream or downstream factors of processing and marketing) there is a sub-support system (supporting services sub-system).

Activities in this sub-system support includes education, training and extension, research and development, capital and insurance, advocacy and legal aspects of procurement regulations that support. In general, sub-systems are interpreted as supporting the activities that should be run by the government. Because individual farmers would not be able to perform that role. However, if farmers move in a solid form of cooperation, it is not possible the various activities of sub-systems supporting them can be carried out by independently and well. Today the welfare level of farmers continues to decline in line with the classic problems they experienced, as well as being part and the dilemma of an agribusiness activities at the level of agricultural producers. Profit levels during this agribusiness activity more enjoyable by the merchants and other agribusiness actors in the downstream. Therefore, the necessary institutional rural economy that can provide power for farmers (high bargaining power).

Community development through cooperatives or farmers 'agricultural institutions/ farmers' groups is an empowerment efforts undertaken consciously planned and truly through the joint efforts of farmers to improve the economy of rural communities keragaan system. The direction of empowerment of farmers will be adjusted with the agreement that has been formulated. With a high participation of cooperatives, is expected to have a sense of community for all activities that implementation of the cooperative will also high. Because in the cooperative values and principles are based on the principle of kinship and mutual aid and cooperation are the foundation itself. In the context of providing access to capital, the farmers collectively can establish a Micro Finance Institution Sustainability (LKMA) legal status of cooperatives. MFIs in Indonesia according to the Asian Development Bank and World Bank (Gunawan Sumodiningrat, 2007) characterized by: (1) Provide a variety of financial services that are relevant or appropriate to the real needs of society, (2)
Serving low-income groups, (3) Using the procedure and mechanisms for contextual and flexible for easy reach by poor people in need.

Meanwhile, build a secondary structure is to focus on the *meso* level. On the institutional side, creating an institutional structure for the benefit of the cooperative members and for other parties to gain access into the business. On the production side and the creation of national production capacity, the presence of secondary and institutional cooperation will contribute to increase production and production capacity of the cooperative efforts of its members. This will then contribute to the increase in national production capacity. Another benefit is the open access of its members and the public in information technology, business, skills enhancement, access to markets both domestically and abroad, raising capital and increasing income of cooperative members. All of these benefits is expected to be contributed by the presence of Cooperative Secondary.

Normatively, ie, the functions of a Secondary Cooperative to build and develop the potential and the economic ability of cooperative members is a function important. Cooperatives Act that have been mentioned explicitly stated that the Cooperative Secondary is a form of institutional cooperative robust and integrated. Institutional cooperation is expected to be able to perform its function of building and developing the economic potential of cooperatives members. In practical terms, cooperatives are expected to Secondary form a venture with a network of Primary Cooperatives and develop mutually beneficial cooperation.

At the *macro* level, the Ministry of small and medium companies and cooperatives (MSME) acts as a facilitator Cooperative movement in Indonesia. At district level the responsibility is in the hands cooperative office (Cooperatives). The main duties of the office of the cooperative is to monitor and oversee the performance of financial cooperatives. At the macro level in close cooperation with the Office of Cooperatives (Cooperatives) applied especially at district level. Office of the cooperatives will always be involved in every activity in micro and meso level.

In the context of financing, the pattern of relationships that are developed to empower SMEs, is the pattern of relationships that is *executing* the executor is responsible for the risk of arrears in principal and overdue interest on the loan. Implementing KUKM is SOE managers and the Financial Executive Institute (CGC). State-Owned Enterprises (SOEs) are financial service providers appointed by the Minister of Finance to channel KUKM while the CGC is a Commercial Bank, Rural Bank/Sharia Rural Banks, Pawn Shops, Credit Unions/Savings and Loan Cooperative Unit, Baitul Maal Wat Tamwil (BMT) and credit institutions are granted the status as the Rural Bank.

In the 1990s, there was renewed discussion of the need for a new rural finance paradigm, a debate that is still under way. This proposal emerged from the lessons of the “old” paradigm and the microfinance revolution. It involved development of a series of basic principles to guide development of a finance system that allows and facilitates rural development, based
on a commercial approach that acknowledges the superiority of the market and its mechanisms for serving a growing number of clients in a sustained manner and accepting the challenge of designing policies, interventions and technologies capable of overcoming or counterbalancing the main shortcomings in financial markets through compatible or intelligent incentives, innovations and new institutional design (of organizations, regulation, etc.).

This new paradigm posits three basic conditions for the development of rural financial markets: the creation of an appropriate regulatory environment (from macro stability to measures for correcting the anti-rural bias of policies); a regulatory and legal framework that allows the development of broad-spectrum financial entities and the better functioning of markets; and the enhancement of rural financial entities to expand their services beyond credit and ensure their sustainability. Conceptual approaches have also been developed to include factors related to the impact of rural finance development on current and potential customers, as well as supply-related elements.

Gonzalez-Vega (2003), one of the promoters of the new rural finance paradigm, stresses that this new vision reveals a series of reasons why public entities should not play a direct role in financial markets (as financial service providers): First, they have no advantages in access to information about potential clients (in comparison to their private competitors), and they tend to have disadvantages in enforcing contracts signed with their customers, because of credibility problems stemming from frequent expectations of debt forgiveness and the government’s limited real (political) power to execute guarantees in case of default. Second, government entities tend to be subject to political pressure and generally lack incentives to be sustainable and/or efficient.

Despite the arguments of Gonzalez-Vega and others, the conference organized by the IDB on the role of public banks and their potential, while not discounting this position, launched an important debate about the areas in which public-sector entities could play a role in developing rural markets, largely because of their extensive networks of branches, which allow them to reach customers who traditionally have not been served by the private system. The debate began with acknowledgement that public entities had failed to promote agricultural development by providing agricultural credit, especially in Latin America, and recognition of the limitations these entities face in avoiding political interference in their decision making. Nevertheless, the conclusions of that meeting suggest that while public entities face serious limitations, they can be transformed to serve clients who are excluded by the private sector. This conclusion is supported by some interesting examples of reforms that have transformed public banks and made them competitive without compromising their relationships with farmers and/or poor customers.

This debate is ongoing. The main justification for the presence of public banks is the private sector’s limited interest in rural areas and low-income borrowers. But there
are also more proactive reasons. The existence of public banks may also serve as a catalyst and lead to strategies. That pave the way for development of the market and, therefore, the entry or emergence of new private institutions. These more proactive reasons include these institutions’ ability to expand the boundaries of the market (toward traditionally unserved sectors), promote actions to reduce transaction costs, create synergies with the private sector, and create positive externalities (such as information, risk centres, etc.).

There are also political reasons for the existence of such entities, which cannot be ignored. In the best sense, these institutions can be part of the political apparatus or can become key stabilizing forces in case of conflict or social unrest. The discussion suggests that there are some consensual recommendations to help development institutions to perform and better served their development goal. Two of them are examined in this paper. The first one is to have whenever is possible second tier institutions, which are cheaper and usually more efficient than first tier operations. The second one is that development institutions need to building shielding mechanisms to protect themselves against public sector intervention and mismanagement.

**CONCLUSION**

While recommendations abound - and, as we have seen, cannot always be implemented

- some proposals, when applicable, seem to lead to more solid, sustainable, proactive banks. These include:

- **The development entities must be financially viable.** While acknowledging that public development entities must meet development goals, which can imply that they must take on tasks that are not very profitable or are unprofitable, strictly financial operations must be financially and operationally sustainable. This is one of the pillars of current debate over development banking, and there is sufficient evidence worldwide and in the region that this goal is not only possible, but that it imposes a series of positive incentives for the institutions.

- **The second tier is a preferable option, but not the only one.** As noted, whenever it is possible for development banking to operate from the second tier, the outcome is good for both the entity and other intermediaries, which have a source of specialized funds. As we have seen in several of the cases analyzed, however, it is not enough to be convinced that it is better for development banking to operate from the second tier. A series of conditions are necessary to make this possible.

- **Various services, not just lending, and with a rural focus, not just agriculture.** This recommendation is increasingly accepted common sense. Rural dwellers and farmers also need other financial services. In many cases, they need these services more than they need loans. Offering a diversity of products and services benefits the development entities, as it enables them to make their installations more profitable,
improve their relationship with customers, gather more and better information about their customers, and facilitate management of the liquidity of their clients and their businesses. In some cases, these services can give impetus to the development of other markets that enhance the performance of finance entities, such as the insurance market. They also make it possible to expand the entity’s range of action and foster a multi-sector approach to lending, improving the risk profile.

- **Partnerships with private intermediaries.** While the most common partnership involves development entities providing private intermediaries with funds, there is much room for collaboration, from arrangements by which private entities can use the development bank’s infrastructure (branches), to agreements for institution building, development and transfer of technology, and models for risk management and transfer. Except for a few examples, however, these partnerships are few, weak, very specific or, worse yet, merely formal.

- **Autonomy, independence and good governance.** While this recommendation seems obvious, judging by the cases reviewed in this study, it is not. In several cases, there were efforts to increase the development bank’s autonomy vis a vis the public sector and political power, but these are still incipient. Most control over development banking remains in the hands of each country’s executive branch, and the presence of private shareholders, independent directors and mechanisms for selecting directors and authorities remain tied to each country’s political cycle. The cases analyzed reflect various ownership and governance models, depending on the particular context. These range from models in which only the public sector participates, those in which the public sector invites private stakeholders, and mixed options with varying degrees of control and involvement by private shareholders and directors, to models in which there is full private control. Nevertheless, it must be noted that the models with the greatest private participation and control do not distance these development institutions from their development objectives.

As a big agenda, this exposure is only a speck of discourse that is far from perfect. A major work, ranging from the maturation of the concept, equating to a vision of all stakeholders to support the government in mainstreaming Shari’ah-based microfinance for farmers, new starts. But always a great leap forward always starts of a small step. Hopefully this little paper raises the interest and enthusiasm far greater than doubled the tips all in an effort to arouse the spirit to work together to achieve this goal.

**REFERENCES**


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