# Bane of rural credit market: presence of money lender or absence of structural synchronicity

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# BANE OF RURAL CREDIT MARKET: PRESENCE OF MONEY LENDER OR ABSENCE OF STRUCTURAL SYNCHRONICITY

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***Introduction***

Working out ways to lift people out of poverty is a key objective within development economics. While there is a great deal of rhetoric on this subject, very little has been understood about what concrete steps can be taken. One policy area that has attracted a lot of theoretical attention is credit, access to which is often seen as critical in enabling people to transform their production and employment activities and to exit poverty. There is, however, a great deal of skepticism as to whether interventions in credit market are capable of reaching the poor. Here, there are two opposing views: the first view, which has been dominant for much of the post-war period, states that expansion of formal lending institutions such as State sponsored commercial banks should be engines of structural change and poverty reduction in rural areas. A second view that does not dispute access to credit is critical to poverty reduction, however, views that government intervention in credit market is either ineffective or counterproductive and cannot canalize credit for the marginalized due to administrative impediments arising from multi agency system (the Central government, the State government, the Local government and the banks). Formal credit in rural areas will, therefore, tend to be captured by rural elites. The elite capture combined with the imposition of interest rate ceilings can lead to financial dualism where formal concessional funds are concentrated in the hands of the powerful few and terms in informal markets. Thus expansion of subsidized formal credit can have the unintended consequence of undermining rural development and increasing rural poverty.

Of the total 1000 million populations in India, approximately 720 million people live in rural India as per 2001 census. Of the total workforce in the country, 66 per cent are in agriculture, which contributes about 27 per cent of the GDP. This obviously explains why

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a large section of the rural people has low income. The challenge before the Indian economy in the face of growing liberalization and free trade agreements world over, is therefore, to canalize resources for sustained growth of the economy and more importantly reduce rural disparity.

***Demand for credit***

There are three segments of demand for rural credit in India (Mahajan: 1997). At the base are the asset poor and asset less rural landless households who are either engaged as seasonal labourers in agriculture, mining, quarrying and the casual workers. The basic credit requirement of this section is for consumption purpose during days of no-work and for other contingencies like sickness, social obligations like marriage etc. However, there is also demand for production credit from this group which essentially caters to the requirements for acquiring small productive assets, such as livestock, through which additional income can be generated.

The second group comprises the small and marginal farmers, rural artisans, weavers and petty traders. The main credit requirement for this group is for working capital (production credit). However, there is requirement for consumption credit also though the size and frequency is comparatively smaller than the earlier group. The demand for consumption credit is essentially for meeting expenses on social obligations and functions.

The third group comprises small and medium farmers and also small salaried job holders. However, while the credit requirement of the farmer class is for production purpose, the salaried small job holders require credit for consumption requirement mostly in terms of acquiring some consumer durable assets or any social obligatory expenses.

It may be noted here that among the three groups, the medium farmers from the third group have been able to access the formal banking institutions for obtaining credit. However, the credit so obtained is purely for production purpose in respect of his farming uses. Therefore, a major demand component for credit in rural India which is for consumption purpose is, however, not available for these groups of people from the formal institutional sources.

Moreover, the demand for short term credit is higher in rural areas since fast cash is needed in all transactions and, liquidity preference of rural households for transaction motive suffers from liquid cash due to low income.

***Credit Intervention in rural markets***

In India, the rural production system has been injected with subsidized finance through financial institutions. The end result of which has been a defaulting credit system, squeezing the viability and sustainability of the rural banking system. The whole idea of cocessional credit to rural areas has been advocated with the objective of releasing the rural poor and marginalized from the clutches of usurious moneylenders comprising the large farmers, resource rich village traders etc. and create a space for credit access to the marginalized and poor section.

The subsidized credit of the formal institutional sources tied to poverty alleviation programme of the government and schematic lending have created multi agency problem and problem of moral hazard in the rural credit market of India (Choudhury: 2004). Adverse selection of beneficiaries, political interference, financing of non viable activities have not only eroded banks credibility and business worthiness, it has also sapped the competitive spirit and entrepreneurial drive to fend for ones own in the rural areas. The resultant effect of this has been a distressed situation in the rural areas. The distressfulness in rural areas is corroborated by the fact that during 1999-2000, at all-India level, 40.85% of the rural households were without cultivated land as against 38.74% in the previous survey round in 1993-94. The average land size possessed by a rural household in India is 0.84 hectares but 41.1 per cent of the rural households possessed land sizes of 0.01-0.20 hectares as revealed by the NSS 55$^{th}$ Round. The average size of land cultivated (per cultivating household) was 0.18 hectare during 1999-2000 as against 0.23 hectare in the 1993-94. While this indicates the increase in number of rural households in terms of loss in asset ownership, the NSS 55$^{th}$ Round data on rural indebtedness shows that average amount of debt per indebted household has increased from Rs.3169.00 in 1993-94 to Rs.8215.00 in 1999-2000 even though there has been a marked decrease in the percentage of indebted households from 35 percent in 1993-94 to 25 percent in 1999-2000. This increase in the size of the debt clearly reflects the credit size expansion in the rural areas.

According to conventional theories of market, an effective market is one where both buyers and sellers have equal presence and, the pay-off matrix places both on an optimum level of satisfaction. In India rural credit market has been unprofitable for schematic subsidised lending of the government. In making concessional credit, it is more pertinent to ask what should be the right measure and approach of such credit. If it is poverty alleviation, the policies for rural credit need to look into the credit needs of households below poverty level. If it is creating employment, then the product market and the linkages to rural areas need to be studied before doling credit.

***Regional growth policy and rural credit market: theoretical underpinning***

It is an undeniable fact that the informal sources like the money lenders charge high rates of interest from the rural borrowers, vast majority of who are both cash poor as well as asset poor. The subsidised credit programme and the regional rural banks were introduced primarily to relieve the poor borrowers from unequal terms of trade with the money lenders. The role of the money lenders and the banks in the rural credit market can be analysed from the theoretical rationale of the regional growth policy. There are two approaches in fostering the growth potential in this respect- *first* by upgrading the local infrastructure especially the outreach in the rural areas to reduce the cost disability of the rural areas and *second*, through introduction of suitable credit products. Regional policies of the first type are supplemented by expansion of the rural branches. However, whether such a policy has the desired local effect is determined by the relationship between the provisions of the accessibility infrastructure, the marginal cost and revenue effects of the changes in accessibility costs on the indigenous local supplier and the non-indigenous localized inter-regional firms (McCann: 2001). Therefore in an ideal situation of the first type, investment in accessibility infrastructure will induce credit flow by non-indigenous localized inter-regional firms by reducing the cost disability. Further the credit promotion through subsidised products is assumed to reduce the marginal cost and increase marginal return for the borrowers and hence generate demand for credit from these firms. However, while addressing these issues in rural credit market, the crucial aspect that has been left behind is the input substitution factor (different types of credit products mainly production credit) in the rural areas. If firms (banks) have a zero or weak factor input substitution effect, localized reduction in accessibility cost will be absorbed by the firms (banks) by moving away from the region to regions with higher availability of factor input substitutes notwithstanding the accessibility cost as because high factor input substitution effect nullifies the accessibility cost differentials. This is the ideal Weber type result, which effectively holds good at present for rural credit market in India. The financial sector liberalization in the wake of the structural reforms has precisely led to credit squeeze in the rural areas. This is due to the fact that demand for production credit in the rural areas is low and hence factor input substitutability process for the firms (banks). The major reason being rural demand for credit is essentially for consumption purpose more specifically household consumption and social ceremonies like marriage etc. Therefore, when firms (banks) have wide range of substitution possibilities together with low accessibility disability cost on a comparative basis between two regions (rural and urban), firms will tend to move towards the region where it has a lower rate of disability cost and higher possibility of substitution. In case of rural areas this has been the case, which is a classic case of the Moses-type result that is entirely in keeping with perspective of regional growth policy. Geography therefore plays an important role in determining the spatial distribution and absolute quantum of economic impacts of regional growth policies. The money lenders by virtue of the localized spatial concentration have the advantage of low cost disability in terms of outreach and also high factor input substitution. The substitution effect is achieved by offering different quantum of credit with respect to purpose, rates of interest depending on the borrower's repayment capacity. This is facilitated by the informal structure of the money lender's business unlike the rules defined process of the formal banks. The low rate of information access coupled with high cost of accessibility led to mounting overdues in the rural bank branches. The structural reforms of the financial sector and the introduction of prudential norms led to merger and closure of many rural bank branches. The rural poor were thus further pushed into tight corners as whatever remote possibility of availing subsidised credit existed for them by virtue of a bank office in their local area also closed down. The question therefore is what options remain for rural poor?

In the emerging situation where the formal agencies have been gradually reducing their outreach in the rural markets in the wake of present financial liberalization (e.g. the total credit outstanding for all scheduled commercial banks in India as on March, 2006 rural India accounted for 8.4 percent), the informal agencies remain the other source. In any business transaction information is the key word. The money lenders enjoy the information advantage of their borrower clientele due to their spatial location. Given the large size of the rural borrower class and a comparative small supplier group of money lenders, it is obvious that the supplier will always look for the highest remunerative option. Studies on rural credit market have shown that high rate of interest on the loan is not a deterrent rather it is the timeliness of the product availability. As the informal lender can supply the product at easy time this brings down the transaction cost in terms of person hours/visits spent compared to the formal agency

In the present era of liberalization, when rural expenditure of the government has been dwindling, decrying the role of the informal agencies notwithstanding their financial intermediation in the process will deny livelihood access to the rural poor and lead to starvation of the rural economy. However, this is not to defend the informal sources, but given the market where there is high demand and low supply, one has to appreciate the fact that high interest rates charged by the money lenders has in fact created a multiplier effect in generating operating funds for further credit accessibility of the rural poor.

***Sustainability of money lenders in rural credit market***

Market is a function of demand and supply hence, sustainability of the market depends on the customer base of the market. In understanding the sustainability of rural money lenders it is important to look into client base which generates the demand for the money lenders credit supply.

Of the total households in rural India, approximately 41 percent of the households are without any cultivable land. Further of the total rural labour households (RLH) 41 percent are with cultivable land while 59 percent are without any cultivable land. In respect of the agricultural labour household (ALH) 43 percent have cultivable land and 57 percent have no cultivable land.

The distribution of RLHs by their usual occupation show that majority of the members of households are without occupation. At all-India level, out of the average household size of 4.67 persons, 2.69 persons were without occupation during 1999-2000. A similar pattern is obtained in case of ALH, at all-India level, for an average household size of 4.65 persons (all-classes), 2.61 persons was without occupation. The percentage distribution of persons by usual occupation and possession of land in respect of RLHs and ALHs revealed that the majority of the persons in these households were without occupation. At all-India level, 57.12 percent of the persons with cultivable land were without occupation while 57.91 percent of the persons without cultivable land were without occupation in respect of RLH. In respect of ALH, 56.29 percent of the households with land and 56.03 percent of the households without land were without occupation. The data bespeaks of the distress livelihood scenario in the rural areas.

In respect of indebtedness the NSS 55$^{th}$ Round indicate that there has been a decline in the incidence of rural indebted households while there has been a sharp increase in the size of debt per indebted household. The distribution of rural indebtedness by sources shows that while 34 percent and 31 percent of the RLH and ALH respectively were indebted to the money lenders banks accounted for only 17 percent of rural indebtedness. A comparative analysis on the rural indebtedness by source shows that except during the period of the 3$^{rd}$ Rural Labour Enquiry (RLE-1977-78) which was the post RRB period and that the incidence of dependence on money lenders showed a decrease for the first time in India. During the 4$^{th}$ RLE (1983) when IRDP was launched which incidentally had been the biggest rural development programme in India the indebtedness of the rural households to money lenders were reported to be even lower than that of the banks. This decrease needs no explanation as evaluation study of IRDP has thrown enough light on its performance and efficacy. As the *make good, look good* aura of IRDP could not sustain for long, and the banks were caught up with non recovery of loans and mounting overdues, the 4th RLE (1987-88) showed a reversal of the 1983 trend and a steady increase on the money lenders incidence of debt supply. The in famous ARDR 1990 which apparently relieved the rural borrowers however brought the much needed succor to the commercial banks as non recovery turned detrimental for the banking system with the rural defaulters remaining nonchalant. Following the financial sector liberalization in 1992, there has been severe credit squeeze in the rural areas by the commercial banks in the country as a whole. As per the RBI Quarterly Report March, 2006, of the total credit outstanding for all scheduled commercial banks (ASCB) rural India accounted for 8.4 percent against a deposit share of 11 percent. In 1992, the share of ASCB credit in rural areas was 13.63 percent while the same for deposit was 14.98 percent. Fourteen years after the financial sector reforms the emerging trend sows that rural areas have been increasingly falling behind in respect of credit accessibility.

The purpose wise breakup of the indebtedness shows that household consumption and social ceremonies like marriage etc. have always been the two important reasons for rural indebtedness, and even today almost 55 percent of the total rural household loans are taken to meet the requirements for these two purposes. The sustainability of money lenders is embedded in these two purposive credit requirements of the rural households which the commercial banks in the rural areas can barely address.

Further, the growing landlessness in the rural areas have constricted the rural households in obtaining bank credit for any production purpose which explains the reason for growing incidence of indebtedness to the money lenders. Also the incidence of indebtedness is directly related to the expenditure level of the rural households. As per the NSS 55th Round data, rural labour households up to monthly per capita expenditure class of Rs.300.00, the incidence of indebtedness is less than the average incidence for all expenditure classes in India. The incidence of indebtedness increases with the expenditure class. The decrease in the overall incidence of rural indebtedness to a quarter of the rural households does not confirm a betterment of rural life- rather it is on the contrary. There are two supporting evidences: *first,* 98 percent of the debts were contracted by the households instead of being inherited and *second,* as indebtedness is directly related to expenditure, therefore in a situation of growing landlessness and no occupation among rural households, the capacity to borrow even from money lenders is getting constricted.

### *In lieu of conclusion*

The LPG of the Indian economy has further pressed the rural economy. That the market forces and various institutional agencies of the liberalised economic structure will bring its own distributive justice in such distressed rural market is too idealistic postulation. Instead of launching rural employment generation programmes and schemes across the country, and inject some cash into the hands of rural households which is highly unsustainable as confirmed by the experience of IRDP, it is important that spatial dimensions of the rural markets are first addressed by assessing the needs for social overhead capital (SOC) and its synchronicity with directly productive activities (DPA). The reason being that the transport/accessibility cost (of SOC) and factor input substitution (of DPA) are two important determinants of any market intervention. Therefore, the real issue before rural credit market is not the presence or absence of money lenders but the synchronicity between SOC and DPA to ensure the sustainability of wage employment schemes to redress the rural poor which have so far been the missing link.

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**RURAL LABOUR ENQUIRY REPORT ON GENERAL CHARACTERISTICS OF RURAL LABOUR HOUSEHOLDS (55th Round of N.S.S.) 1999-2000**

**Table: 1 - Rural Indebtedness**

| **Items** | **Agricultural Labour Households** | | | | | | | **Rural Labour Households** | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1st RLE | 2nd RLE | 3rd RLE | 4th RLE | 5th RLE | 6th RLE | 7th RLE | 1st RLE | 2nd RLE | 3rd RLE | 4th RLE | 5th RLE | 6th RLE | 7th RLE |
| | 1963-65 | 1974-75 | 1977-78 | 1983 | 1987-88 | 1993-94 | 1999-2000 | 1963-65 | 1974-75 | 1977-78 | 1983 | 1987-88 | 1993-94 | 1999 -2000 |
| **1** | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
| Percentage of indebted households | 60.6 | 66.4 | 52.3 | 51.1 | 39.4 | 35.5 | 25.1 | 59.2 | 65.4 | 50.5 | 50.4 | 39.1 | 35.1 | 25.0 |
| Average debt per household(in Rs) | 148 | 387 | 345 | 774 | 769 | 1031 | 1312 | 148 | 395 | 348 | 806 | 787 | 1113 | 1515 |
| Average debt per indebted household (in Rs)- | 244 | 584 | 660 | 1516 | 1952 | 2901 | 5230 | 251 | 605 | 690 | 1598 | 2014 | 3169 | 6049 |

**Table: 1.1- Percentage of rural debt by purpose**

| | **Agricultural Labour Households** | | | | | | **Rural Labour Households** | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1963-65 | 1974-75 | 1977-78 | 1983 | 1987-88 | 1993-94 | 1999-2000 | 1963-65 | 1974-75 | 1977-78 | 1983 | 1987-88 | 1993-94 | 1999 -2000 |
| **1** | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 |
| Household consumption | 53.3 | 48.1 | 44.4 | 30.4 | 34.3 | 32.3 | 31.0 | 51.8 | 47.0 | 42.9 | 32.0 | 33.6 | 29.9 | 27.6 |
| Marriage & other ceremonies | 24.2 | 18.8 | 22.3 | 14.7 | 13.8 | 17.1 | 24.1 | 24.7 | 19.3 | 22.9 | 15.5 | 15.4 | 17.8 | 24.0 |
| Productive purposes | 11.9 | 12.7 | 20.9 | 41.4 | 29.1 | 28.3 | 21.5 | 12.0 | 12.7 | 20.4 | 38.2 | 26.9 | 25.3 | 18.5 |
| Land purchase & constr. of building | - | - | - | 6.3 | 8.5 | 10.0 | 14.6 | - | - | - | 7.6 | 11.1 | 15.0 | 21.0 |
| Repayment of debt | - | - | - | - | 1.2 | 1.7 | 1.0 | - | - | - | - | 1.1 | 1.8 | 1.0 |
| Others purposes | 10.6 | 20.4 | 12.4 | 7.2 | 13.1 | 10.6 | 7.8 | 11.5 | 21.0 | 13.8 | 6.7 | 11.9 | 10.2 | 7.9 |

| Table: 1.2-Percentage of debt by source | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Items** | **Agricultural Labour Households** | | | | | | | **Rural Labour Households** | | | | | | |
| | **1963-65** | **1974-75** | **1977-78** | **1983** | **1987-88** | **1993-94** | **1999-2000** | **1963-65** | **1974-75** | **1977-78** | **1983** | **1987-88** | **1993-94** | **1999 -2000** |
| **1** | **2** | **3** | **4** | **5** | **6** | **7** | **8** | **9** | **10** | **11** | **12** | **13** | **14** | **15** |
| Government | - | - | - | 2.9 | 3.6 | 8.2 | 4.1 | - | - | - | 4.1 | 3.6 | 8.3 | 5.4 |
| Co-operative societies | 4.9 | 5.3 | 8.6 | 7.9 | 10.0 | 7.0 | 10.3 | 5.6 | 5.6 | 9.4 | 10.2 | 9.4 | 7.9 | 13.1 |
| Employers | 19.7 | 10.1 | 7.0 | 13.9 | 13.0 | 12.2 | 7.9 | 17.9 | 9.6 | 6.7 | 12.2 | 12.2 | 11.4 | 6.9 |
| Money lenders | 30.7 | 47.8 | 37.3 | 18.6 | 22.0 | 29.4 | 34.0 | 31.9 | 46.4 | 36.7 | 21.3 | 21.7 | 27.6 | 31.7 |
| Shop-keepers | 7.4 | 6.7 | 6.7 | 4.6 | 7.7 | 6.9 | 6.9 | 8.4 | 7.3 | 6.8 | 5.3 | 9.2 | 7.3 | 7.1 |
| Banks | - | 3.6 | 6.0 | 33.3 | 21.0 | 20.7 | 16.6 | - | 4.0 | 6.5 | 28.0 | 20.8 | 18.9 | 17.2 |
| Relatives & friends | - | - | - | 10.8 | 13.7 | 12.9 | 16.1 | - | - | - | 11.6 | 14.4 | 12.4 | 15.1 |
| Others | 37.3 | 26.5 | 34.4 | 8.0 | 9.0 | 2.8 | 4.0 | 36.2 | 27.1 | 33.9 | 7.3 | 8.7 | 6.2 | 3.5 |