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DELIVERY OF CREDIT TO RURAL POOR

by

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DELIVERY OF CREDIT TO RURAL POOR

B.M. Desai

Summary

Four questions that are raised in this paper are:

- (1) Why is it necessary to reserve formal credit for rural poor?
- (2) Is credit a constraint on increasing production and incomes of the rural poor?
- (3) Is existing credit delivery conducive to increasing their incomes? And
- (4) What improvements are required to make this delivery more effective in increasing their incomes? Answers to these questions are proposed by abstracting out the real-world experiences in India. Wherever possible empirical support is also given.

For analytical convenience issues that may be examined for delivery of credit can be classified into two categories. One, those that could get considered prior to sanctioning credit. And, two, those that could be considered once credit is sanctioned, for its disbursement. The paper is restricted to the latter category of issues.

The formal lenders seem to have overemphasized the "cash" form of delivering and recovering credit. More importantly they seem to have overstressed the idea of providing this form of credit "directly" to the farmers. In this process, they have neglected integration of informal credit market with the formal one. Additionally, they seem to have accentuated the very forces which lead to "market imperfections" and "conflict" between private and social objectives of the formal lending

agencies. Indeed, solutions to overcome these problems may be found in increasing use of financial instruments like rediscounting of bills and papers, and that of institutional and private agents for delivery and recovery of credit. In either case there is a clear need to provide for (i) least time in delivering and recovering credit, (ii) sufficient choice in the terms and conditions at which credit in kind is made available, and (iii) sufficient choice in terms and conditions at which marketing facilities are made available to induce prompt and regular loan repayments. This is because realising incomes and output increases by the rural poor entails not only access to credit but also to appropriate technology, inputs and commodity market facilities. Thus, generating effective and efficient access to these factors should form the important component in determining terms and conditions for delivering and recovering credit from the rural poor.

II

Reservation of Credit

A priori, reservation of formal credit for rural poor is justified on at least two grounds. First, when the share of poor households in the available loanable funds is relatively small because of the imperfections in the rural credit market (Krishna, 1978). Imperfections in this market may arise due to, among other factors, socio-political, institutional, and infrastructural factors. Secondly, reservation is needed because of the conflict between private and social objectives of the formal lending institutions. This argument runs somewhat as follows:

If these institutions are left to themselves, then they would tend to lend relatively more to the larger farmers to protect their costs from rising. A priori, they would expect both administrative costs and default risk to be lower in this event¹ [Desai, 1978 (a)]. These costs being financial costs to these institutions, their financial viability is expected to be better ensured. This is despite the fact that the increases in farm output may be smaller when credit is concentrated with such farmers rather than with the poor ones.² Increases in farm output are however, not a financial benefit to the lending institutions. In their concern to fulfil their private objective they are therefore compelled to lend relatively less to the poor households. The net benefits to the lending institutions in this case are expected to be higher, although the net benefits to the society as a whole may be lower.³ Hence arises the conflict between private and social objectives of these institutions. Policy instruments of a wide variety are therefore used to compensate and thereby induce the lending institutions to fulfil their social objective. For example, risk funds are given to these

¹The past experiences about the default rate among different sized farms are, however, contrary to this a priori expectation [Desai 1978(b)]

²Even when increases in farm output are larger when credit is concentrated on large farmers the net benefit to the society may be lower because such society may attach much lower weight to the income increases that are relatively shared more by the large farmers.

³In the calculus of social benefit cost analysis of these institutions the increases in output are considered a social benefit. The increases in administrative costs are considered a social cost, because they consume nation's resources. But increases in default rate is not a social cost as they represent mere transfer payments from one to another. The net benefit to the society may be higher if credit is not concentrated with the larger farmers, although the net benefits to the lending institutions could be lower in this event.

institutions to provide a cover to the bad and doubtful debts that may arise when they lend to poorer households. Similarly, concessional refinance facilities and also a subsidy to meet higher managerial costs are provided. These instruments are believed to aid reservation of formal credit for the rural poor.

Is Indian public policy guided by the "imperfect market" related or the "conflict" related justification for reservation of formal credit for the rural poor? Answer seems to be that it is guided by both these factors.

III

Credit Constraint on Production

Is credit a constraint to increasing poor households' incomes and output? Answer is both 'yes' and 'no'. It is 'yes' in the sense that delivering credit is a necessary condition to raising their output and incomes. However, realizing these increases by such households requires something more than credit [Dantwala 1966]. Access to profitable and less risky technology, and also to modern inputs and product markets are some of the other requirements of these families [C.H.H. Rao 1970 and 1976, Vyas 1968 and 1978, Mellor 1966, and Donald 1976]. It is in this sense the answer is 'no'. Hence delivering credit alone is not a sufficient, although a necessary, condition to increasing output and incomes of these families. Indeed in the absence of the access to appropriate technology, modern inputs and product markets fulfilling

necessary condition can result into a self-defeating process of immiserisation of these families. This is because their liability to meet loan obligations increases without increases in their incomes. In such condition they sometimes borrow from informal lenders or even liquidate the assets they have purchased from the formal credit to repay these loan obligations [Desai and Varma 1978, RBI, 1975(a)]. Evidence showing such outcomes are easier to find than those showing successful outcomes of delivering credit. The latter type of evidences are invariably found when the access to other requirements is also met [Desai and Naik 1971, Jodha 1974, Krishna 1978, Maitra 1978, Patil 1978]. Even among such cases there may exist some which begin to show uncertainty about the continuity of the initial increases in output and incomes [Pachauri 1978, Maitra 1978, Kingra 1978]. This is mainly because of the weakening of the access to requirements other than credit. It is also partly because of lack of access to working capital credit. To conclude, delivering credit in isolation of other requirements is self-defeating to the very objective of improving the incomes of the rural poor. This is particularly so when the informal lenders can relatively easily meet the other requirements for the level of technology used by such families [Desai 1976].

Has the consensus on these conclusions emerged in India from its recent experiences of the programmes like SFDA, MFAL, etc? Answer seems to be in the affirmative [Pandey 1974, RBI 1975(a), RBI 1976, Maitra 1978, Desai and Varma 1978, and Shah 1978]. Similar consensus is also emerging from the experiences in other developing countries [Lelo 1976, Donald 1976, Adams and Tommy 1974, and Lipton 1977].

IV

Existing Credit Delivery

The features of existing credit delivery in India are now discussed for crop loans, consumption loans, term loans for purchase of minor irrigation assets, and term loans for purchase of milch animals. Both the cooperatives and commercial banks' delivery of credit for these purposes would be discussed. Moreover, with a view to judging how good is the access to credit and also to other requirements of the rural poor for increasing their income features of the delivery of credit can be discussed with reference to (1) length of time taken to deliver credit after the sanction is decided, (2) time at which it is recovered, (3) forms and arrangements through which credit is delivered, and (4) forms and arrangements through which credit is recovered. The incentives that the first two variables would provide to the borrowers to increase their production and incomes are too obvious to elaborate here. However, the remaining two variables need some elucidation.

Credit being highly fungible it can be transformed into any use. Hence the forms and arrangements for the delivery of credit should be such that they improve the possibility of using credit for the purpose for which it is given. More importantly, the terms and conditions associated with the various forms and arrangements by which credit is delivered would determine the access to other inputs and services. This in turn would determine the extent of increases in output and incomes of the borrowers. Moreover, these forms must be such that they do not result into use of lot of time in disbursing loans. What is stated about

the effects of forms in which credit is given is also applicable to the effects of the forms and arrangements by which credit is recovered. Recovery of credit through marketing of produce implies making available an access to commodity market. Similarly recovering credit in the form of labour work services implies providing an access to labour market. Both of these are true for the forms in which informal lenders recover loans. Money lenders' forms of loan disbursement may ensure use of credit for intended purposes. Their forms of credit recovery imply, from the borrowers' viewpoint, not only flexibility but also an assured access to marketing of output and even to the employment or rather work opportunities⁴ [Desai 1976, Ghatak 1976, Wharton 1975, Hopper 1961].

Due to non-availability of data it is not possible to quantify the effects of the earlier mentioned four variables. However, one often hears about the delays in disbursement of loans, and also about the unsuitable dates for repayment of loans.⁵ More serious problem is the inadequacy of the existing forms and arrangements by which credit is both delivered and recovered by the lending institutions in India. To this we now turn.

⁴ The commonly found bonded labour in rural areas has its roots in the multiple function system of the informal lenders. Their multi-functional role by way of providing credit, marketing and employment or work opportunities implies that there is a clear need to recognize the importance of multiple services for strengthening credit programmes aimed at rural development. Among the various services and inputs needed the formal credit agency including credit co-operatives unlike the informal lenders would find complex directly organize work or rather employment opportunities for the rural poor.

⁵ These factors together with inadequate supervision of credit use are considered to have their bearing on diversion and overdues of loans [RBI, 1975(b), Desai and Rao 1978].

Loans for the earlier mentioned four purposes can be delivered in the form of cash or inputs/assets/materials or a combination of the two. While crop-loans are supplied in some combination of these two forms by both cooperative and commercial banks, the consumption loans are invariably given in cash by these institutions except by the grain co-operatives. Term loans for purchase of minor irrigation assets and that for dairy-animals are also given in both these forms, although the cash form is perhaps more widely prevalent. Lack of data preclude us from quantifying the proportions in which total credit is delivered in cash and kind forms by the two types of institutions. Required data for this are readily available only for two years for crop-loans supplied by co-operatives. In 1974-75 they delivered credit in kind to the extent of about 23 percent of the total crop-loans advanced. The corresponding proportion for 1973-74 was only 10 percent.

The existing devices of delivering crop-loans in kind by the commercial banks, and those for term-loans in kind for the purchase of minor irrigation assets and dairy animals by both cooperatives and commercial banks can be classified into the following three:

- (a) reimbursement, against the cash receipts, to the borrowers for the prior cash payments made by them for the purchase of inputs/materials/assets,
- (b) direct payments to the dealers (either in cash or by cheque) who sell these inputs/materials/assets to the clients sanctioned credit, e.g. dairy-animals purchased from cattle market,

- (c) making payments through an agri-card⁶ or some such system, to the dealers who are appointed in advance to sell inputs to the clients sanctioned credit.

Considering the discussions in Sections I and III the ranking of preferences of both poor rural families and that of the lending institutions for the three types of existing devices is hypothesized in Table 1. Due to non-availability of data on costs and benefits associated with the three devices, the hypothesized results could not be examined for their validation or otherwise.

Table 1 Hypothesized Ranking of Preferences For Alternative Devices of Delivering Credit in Kind

Devices	Ranking by	
	Poor Families	Lending Institutions
(a) Reimbursement against cash receipts to the borrowers	3	1
(b) Making direct payments to the dealers who sell to the clients sanctioned credit	1	2
(c) Making payments through an agri-card or some such system to the dealer appointed in advance for the clients	2	3

⁶ An agri-card entitles the holders to purchase his seasonal recurring requirements from approved dealers on presentation of the card with out any transaction in cash. This system has been introduced by one of the nationalised banks in India.

Compared to the forms in which credit is delivered, the forms through which it is recovered by the two types of agencies are highly restrictive. In 1974-75 cooperatives recovered crop-loans through marketing of produce to the extent of about 12 percent of their out-standing loans. This percentage has not much changed since 1968-69 (Table 2). Similar data for commercial banks are not available, although all crop-loans except sugarcane loans advanced by them are recovered only in cash. Instances of recovering term-loans given by these banks for purchase of milch-animals through milk cooperatives are fairly common. In such instances also effectiveness and efficiency of the arrangements through which credit is recovered very greatly. Partly this could be because the non-credit institutions are not rewarded for providing services that aid recovery of loans Maitra 1978, Kingra 1978.

The existing forms of recovering loans for the earlier mentioned four purposes by the two types of lending agencies can also be classified as follows:

- (a) Directly from the clients;
- (b) Adjusted against the sale proceeds of the clients obtained from marketing operations of the agency itself; for example, credit-cum-marketing cooperative societies recover loans by marketing the produce;
- (c) Adjusted against the sale proceeds of the clients obtained from the assured marketing facilities provided by agencies other than lending agencies.

Table 2

Forms of Crop-Loans Advanced and Recovered
by Primary Agricultural Cooperative Societies
in India

(Amount in '000 Rupees)

Years	Total Amount Recovered	Amount Recovered Through Marketing	Amount of Loan Advanced	Amount of Loans Advanced in Kind	3 as a % of 2	5 as a % of 4
1	2	3	4	5	6	7
1961-62	34,30,750	NA	46,10,817	NA	1.7	-
1968-69	42,09,679	4,48,014	52,19,271	NA	10.6	-
1969-70	45,52,368	4,06,007	48,77,692	NA	8.9	-
1970-71	50,46,466	4,78,279	51,93,377	NA	19.5	-
1971-72	53,61,849	5,97,234	54,09,445	NA	11.7	-
1972-73	65,53,183	7,03,993	61,27,498*	NA	10.7	-
1973-74	66,93,090	6,92,329	69,05,213	7,12,350	10.3	10.3
1974-75	78,15,547	9,08,511	78,25,977	18,42,422	11.6	23.5

Sources: Reserve Bank of India, Statistical Statements Relating To the Cooperative Movement in India, 1961-62, and 1968-69 through 1974-75, Part I, Credit Societies.

*Includes medium-term loans; break up of Rs.3,65,000 not available.

NA = Not Available.

In Table 3, the hypothesized ranking of preferences for these three alternative devices are presented. These hypothesized results could also not be tested for their validity, because of nonavailability of data on costs and benefits associated with these alternative devices. However, results presented in both Table 1 and 3 show lack of synchronization in the preferences of lenders and borrowers.

Table 3

Hypothesized Ranking of Preferences
For Alternative Devices For Recovery
of Loans

Devices	Ranking by	
	Poor Families	Lending Institutions
(a) Directly from the clients	3	2
(b) Adjusted against the sale proceeds of the clients of the clients obtained from the marketing operations of the lending agency itself	1	3
(c) Adjusted against the sale proceeds of the clients of the clients obtained from the assured marketing facilities provided by other agencies	2	1

Before we conclude, the above discussed hypothesized rankings could be further refined if accurate information can be obtained on (i) time taken in delivering and recovering loans (ii) extent of choice

in the terms and conditions including selection of various inputs and the unit cost of acquiring them by way of loans, and (iii) extent of choice in the terms and conditions including prices at which marketing facilities are made available to induce prompt and regular repayment of loans. The results intended behind delivering credit in kind and recovering it through marketing services will not arise, if these three factors are not adequately considered. Limitations that arise from such inadequacies are often reported to have inhibited the growth in incomes and output of the smaller farmers. Indeed, therefore, these three factors constitute the major directions in which delivery of formal credit needs to be improved.

V

Conclusions

To conclude, the formal lenders seem to have overemphasized the "Cash" form of delivering and recovering credit. More importantly they seem to have overstressed the idea of providing this form of credit "directly" to the farmers. In this process, they have neglected integration of informal credit market with the formal one. Additionally, they seem to have accentuated the very forces which lead to "market imperfections" and "conflict" between private and social objectives of the formal lending agencies. Indeed, solutions to overcome these problems may be found in increasing use of financial instruments like rediscounting of bills and papers, and that of institutional and private

agents for delivery and recovery of credit. In either case there is a clear need to provide for (i) least time in delivering and recovering credit, (ii) sufficient choice in the terms and conditions at which credit in kind is made available, and (iii) sufficient choice in terms and conditions at which marketing facilities are made available to induce prompt and regular loan repayments. This is because realising incomes and output increases by the rural poor entails not only access to credit but also to appropriate technology, inputs and commodity market facilities. Thus, generating effective and efficient access to these factors should form the important component in determining terms and conditions for delivering and recovering credit from the rural poor.

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