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An overview of Borrowing and Rural Credit Policy in India

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Abstract: There is an excess of expenditure over income among the poor and to bridge the gap credit is important. The poor do not have sufficient and reliable access to credit from the formal banking system for a number of reasons. These relate to the inability of the poor to provide adequate physical collateral and transaction costs due to cumbersome banking procedures while dealing with large number of small borrowers and risk costs of lending institutions associated with timely repayment of the loans. There is a need to relieve the farmers from private debt carrying high interest rate by transferring it to institutional agencies. Farmers' indebtedness was strikingly a regional phenomenon; it was low in less developed states.

Key words: Rural credit, Green Revolution, lending institutions

Introduction

It is fact that increase in population has caused more sub-division of landholdings, which has further increased the number of marginal and small farmers. The benefits of new agricultural technology in agriculture are mainly confined to the farmers with larger holdings and those with smaller holdings still continue to have traditional methods of cultivation, because they are unable to make heavy investment for better irrigation facilities, seeds, fertilizers and machinery. It is evident that the benefits of Green Revolution have not been reaped equally by all the farmers, the marginal and small farmer left to their plight of having almost the same level of living. This has pushed them into more poverty and indebtedness. As the informal credit institutions of the developing countries could not meet all the credit needs of rural poor, institutional changes were made and subsidized credit programmes were introduced. However, the proposed objective of improving the access of credit to the poor could not be realized. On the contrary, these programmes resulted in a more unequal distribution of credit leading to the rich cornering the benefits (Emil Mathew, 2006).

Objective of the present paper

An attempt has been made in the paper to assess the borrowing and Rural Credit Policy in India.

Credit Policy for the Rural Poor

Generally, there is an excess of expenditure over income among the poor and to bridge the gap credit is important. The poor do not have sufficient and reliable access to credit from the formal banking system for a number of reasons. These relate to the inability of the poor to provide adequate physical collateral and transaction costs due to cumbersome banking procedures while dealing with large number of small borrowers and risk costs of lending institutions associated with timely repayment of the loans. The risks or uncertainties in the credit market often arise from the problem of information asymmetry. The problem of information asymmetry can be solved but it is costly for the lending institutions. The microfinance groups, based on the principle of joint liability, have the potential to solve the problem of information asymmetry and improve access to credit for the poor. The information problems in the credit market impose certain costs on the lenders and they are ex-ante costs of adverse selection and ex-post costs of moral hazard (Lin and Nugent, 1995). The former relates to the imperfections on the information regarding the creditworthiness of the borrower or his/her willingness to make repayment, whereas the latter relates to his/her ability to make repayments. As it is costly to gather information on these two major aspects of credit transactions, the rural credit markets deviate from the classical assumption of perfect competition and therefore, these markets are imperfect. The imperfect credit markets bring down the total volume of the loanable funds transacted. The costs involved in acquiring information about these two aspects often lead to a market failure and constrained Pareto efficiency (Besley, 1994). However, credit market failure of such kind in the institutional sources of credit can be brought down once information about the transactions is obtained.

Incidence of Indebtedness

Since what is intended is to get an over view of the magnitude of the problem and its relationship to aspects having a bearing on indebtedness, the conceptual differences widely noted on various issues in All-India Debt and Investment Surveys are not considered as insurmountable impediments, though the need for caution in interpreting the trends should not be lost sight off. Indebtedness has long been treated as a distress phenomenon. It is indeed so if the debt taken is not used for productive purposes like purchase of inputs that augment output or creation of assets that augment the earning base of the borrowers and instead is used for consumption purpose or marriages and social ceremonies. Debt can also become a distress phenomenon if the borrower's crop fails due to natural calamities, or if production becomes uneconomic because of high input costs, stagnant technology and lack of remunerative prices which make it impossible for the farmer to repay his capital and interest. Finally, interest becomes a heavy liability if the loan is taken from non-institutional sources at high rates of interest. The accumulated liability of principal and compound interest can sometimes become crippling, and the borrower is forced to mortgage or sell his land losing thereby his only means of livelihood (Radhakrishnna R, 2007). Therefore, the growing indebtedness of the rural poor households is a matter of concern and deserves one's attention.

The first two surveys (i.e., 1951-52 and 1961-62) were conducted by the Reserve Bank of India (RBI) while the next two surveys (i e, 1971-72 and 1981-82) were conducted jointly by the National Sample Survey Organization (NSSO) and the RBI, with the responsibility of field work vested with the former and the processing of data and publication of the results with the latter. As against this, the NSSO was vested with the complete responsibility of conducting the survey, processing and publication of the results of the fifth decennial survey relating to 1991-92. The SAS conducted by NSSO during January-December 2003 in its 59^{th} Round, provide insights into varied dimensions of farmers' indebtedness in India for the year 2003 and presented in Table 1.

Table 1 Proportion of Households Reporting Debt (As on June 30)

	1951	1962	1971	1981	1991	2003
Rural households	63.3	62.8	41.3	19.4	32.0	48.6

Source: All- India Debt and Investment Surveys

It may be seen that the indebtedness of rural households was marginally lower at 62.8 per cent in 1962 over that of 1951 (63.3 per cent) whi-ch decreased significantly to 41.3 per cent in 1971 and further to 19.4 per cent in 1981 (Table 2).

Table 2. Incidence of Indebtedness in Major States: 2003

State	Number of Indebted Farmer	Per cent of Indebted Farmer	Average loan Per Household,
	Households	Households	Rupees
Andhra Pradesh	49493	82.0	23965
Tamil Nadu	28954	74.5	23963
Punjab	12069	65.4	41576
Kerala	14126	64.4	33907
Karnataka	24897	61.6	18135
Maharashtra	36098	54.8	16973
Haryana	10330	53.1	26007
Rajasthan	27828	52.4	18372
Gujarat	19644	51.9	15526
Madhya Pradesh	32110	50.8	14218
West Bengal	34696	50.1	10931
Orissa	20250	47.8	5871
Uttar Pradesh	69199	40.3	7425
Himachal Pradesh	3030	33.4	9618
Bihar	23383	33.0	4476
Jammu & Kashmir	3003	31.8	1903
Assam	4536	18.1	813
All -India	434242	48.6	12585

The incidence had increased to 32 per cent in 1991 and 48.6 per cent in 2003. The steep decline in the proportion of rural households reporting debt during 1971 and 1981 gave rise to much debate although the decline in the proportion between 1961 and 1971 did not raise any debate as the shift in pattern of households debt from non-institutional debt to institutionalized debt was a welcome sign during this period. In view of the expansion of branch network of scheduled commercial banks into the rural and unbaked areas during 1971 and 1981, the decline in the incidence of indebtedness of rural households was contrary to general expectations. The debate pointed towards the limitations of sampling design adopted for the survey and to certain other non-sampling issues.

In 2003, of the 89.33 million farmer households estimated, the SAS shows that 43.42 million (48.6 per cent) were indebted (Table 2.2). In other words, more than half i.e., 45.91 million or 51.4 per cent – were no t indebted either from institutional or non-institutional sources. A large proportion of them might have been financially excluded. The average outstanding debt per farmer household was at Rs.12, 585 and per indebted farmer household was at Rs.25, 902. A state-wise analysis showed that in 2003 incidence of indebtedness was higher in states which had input-intensive or diversified agriculture. The incidence of indebtedness was the highest in Andhra Pradesh followed by Tamil Nadu, Punjab, Kerala, Karnataka, Maharashtra and Haryana (Table 2). Average debt per farmer was higher in states with higher incidence of outstanding debt.

Debt by Source: In 2003, the total debt of farmer households was estimated at Rs. 1.12 lakh crore. Of which Rs.65,000 crore was from institutional agencies and Rs. 48,000 crore from non-institutional agencies. Private moneylenders accounted for Rs.29,000 crore and traders Rs.6,000 crore. About Rs 18,000 crore of debt from non-institutional sources, a major portion of which was from moneylenders, carried an interest rate greater than 30 percent. There is an urgent need to relieve the farmers from private debt carrying high interest rate by transferring it to institutional agencies. The share of institutional sources in cultivators' debt improved considerably in the years following bank nationalization, from about 32 percent in 1971 to 66 percent in 1991, but in the 1990s, there was a loss of momentum and the share declined to 61 percent in 2002 (Table 3).

Table 3 Debt Share of Cultivator Households from Different Sources (in percentages)

Sources of credit	1951	1961	1971	1981	1991	2002
Institutional	7.3	18.1	31.7	63.2	66.3	61.1
Cooperative Societies/ Banks, etc	3.3	2.6	22.0	29.8	30.0	30.2
Commercial Banks	0.9	0.6	2.4	28.8	35.2	26.3
Non-institutional	92.7	81.3	66.3	36.8	30.6	38.9
Moneylenders	69.7	49.2	36.1	16.1	17.5	26.8
Unspecified	-	-	-	-	3.1	-
Total	100.0	100.0	100.0	100.0	100.0	100.0

*Debt refers to outstanding cash dues.

Source: RBI All-India Rural Credit Survey 1951-52; RBI, All - India Rural Debt and Investment Survey, 1961-62 and NSSO. All -India Debt and Investment Surveys. 1971-72, 1981-82, 1991-92 and 2003

In the post-nationalization period, the increase in the share of commercial banks was rapid and sizeable. The cooperative sector's share increased from 22 percent in 1971 to about 30 percent by 1981 and stagnated since then. In the1990s, while cooperatives sustained there, albeit low, share at 30 percent, the share of commercial banks slipped from 35 percent in 1991 to 26 percent in 2002. The decline in the share of institutional agencies in the 1990s could be attributed to the decline in the share of commercial banks.

Debt by Interest Rates: The interest rates charged by non-institutional agencies were much higher than those charged by institutional agencies for the outstanding debt as on end June 2002 (Table 4). About 85 percent of outstanding debt of cultivator households from institutional agencies was in the interest range of 12 to 20 percent per annum. On the other hand, 36 per cent of cultivator households' outstanding debt from non-institutional agencies was at the interest rate of 20 to 25 percent and another 38 percent of outstanding debt at high interest rate of 30 percent and above. This shows the exploitative nature of non-institutional credit market.

Table 4. Distribution of Debt by Interest Rates and Source for Cultivator Households: 2002

Interest rate	Institutional	Non-Institutional
Nil	0.5	17.4
0-6	1.8	2.3
6-10	3.0	0.3
10-12	7.4	0.6
12-15	50.0	1.6
15-20	34.8	2.7
20-25	1.4	36.2
25-30	0.0	0.3
>30	0.3	38.2
All	100.0	100.0

Source: NSSO, Household Indebtedness in India,

Debt by Purpose: A significant proportion of cultivator households' debt was for productive purpose at the all India level (Table 2.8). However, debt for productive purposes as a percentage of total debt declined from 72 percent in 1981 to 63 per cent in 2002. Similarly the share of debt incurred for farm business declined from 64 per cent in 1981 to 53 per cent in 2002. Within farm business expenditure, the share of capital expenditure declined from 45.3 per cent to 34.3 per cent. The increase in capital expenditure for non-farm business could not fully compensate the fall in farm business expenditure, which resulted in a fall in the share of overall productive expenditure between 1981 and 2002. There were substantial inter-state variations in the purposes for which debt was incurred (Table 5). Outstanding debt for productive purposes varied from 40 per cent in Assam, 44 per cent in Kerala and 47 per cent in Bihar to 80 per cent in Maharashtra, 78 per cent in Karnataka and 75 per in Gujarat. The outstanding debt in the states which reported suicides (Andhra Pradesh, Karnataka, Maharashtra and Punjab) was incurred largely for productive purposes.

Table 5. Distribution of Debt by Purpose among Rural Cultivator Households: 1961-2002 (in percentages)

Purpose	1961	1971	1981	2002
Productive	40.1	54.0	71.6	62.9
Farm- Business	36.6	49.7	63.8	52.5
Capital Expenditure	26.8	34.7	45.3	34.3
Current Expenditure	9.8	15.0	18.5	18.2
Non -Farm- Business	3.5	4.3	7.8	9.4
Capital Expenditure	1.4	3.2	6.3	7.4
Current Expenditure	2.1	1.1	1.5	2.0
Non-Productive	60.0	46.0	28.4	38.1
Household Expenditure	49.2	37.8	20.0	27.7
Other purposes	10.8	7.2	8.4	10.4
Repayment of Debt	5.0	1.5	0.1	1.5
Expenditure on Litigation	1.8	0.7	0.8	0.3
Financial Investment	0.2	0.2	1.0	0.6
All purposes	100.0	100.0	100.0	100.0

Source: RBI, All- India Rural Debt and Investment survey, 1961-62 and NSSO, All-India Debt and Investment Surveys, 1971-72, 1981-82 and 2003

Incidence of Borrowings and Repayments by Occupation Category:

Table 6. Percentage of Households Reporting cash Borrowings (IOB), cash Repayments (IOR) and Average amount of Borrowings (AOB), Repayments (AOR) per Household by Occupational Category of Households (2002-03) (All-India) Rural

Occupational Category of Households	Indebtedness		Borrowings		Repayments	
	IOI (%)	AOD (Rs.)	IOB (%)	AOB (Rs.)	IOR (%)	AOR (Rs.)
Cultivator	29.7	9261	22.4	4446	16.9	2006
Non-Cultivator	21.8	4991	18.4	2657	15.9	1202
All	26.5	7539	20.8	3726	16.5	1682

Source: Household Borrowings and Repayments in India.2002 – 03, All- India Debt and Investment Survey NSS 59th Round Jan-Dec 2003 NSSO, January 2006

Table displays the incidence of cash borrowings (IOB), i.e. percentage of households reporting cash borrowings, along with the average amount of (cash) borrowings (AOB) per household by occupational categories, during the period of survey (AY 02-03). The table also displays side by side the incidence of cash repayments (IOR) per household and average amount of repayments (AOR) of cash borrowings during the period of survey. While the incidence of indebtedness (IOI) as on 30.6.02, in the rural areas, was about 27 per cent (NSS Report No.500), the incidence of cash borrowings was 21 percent during 2002-03. The average amount of cash borrowings per rural household was Rs. 3726. A comparison of IORs and AORs together with the IOB and AOB, perhaps, indicates that the incidence of indebtedness is likely to increase in the areas if the relationship between borrowings and repayments observed in the survey continues with same direction, i.e., IOR and AOR are less than the IOB and AOB, respectively in the future years.

Changing Role of Credit Agencies

The study reveals that throughout the last three decades, maximum amount of institutional borrowings of rural households were from 'co-operative societies', although its share in TCB rose from 14.9 per cent during 1971-72 to 26.3 per cent 36 during 1981-82 but fell marginally to 25.7 per cent during 1991-92 with a substantial rise thereafter to 28.1 per cent during 2002-03. 'Commercial banks' closely followed the 'co-operative societies', with its share in T CB soaring by 21 percentage points during the 1970s, the post-nationalization decade, to reach a significant 23.1 per cent during 1981-82, from where it fell to 20.7 per cent during 91-92. During the 1990s, however, the corresponding share gained by 2 percentage points. The share of government departments ranged between 2.7 per cent to 4.2 per cent throughout these three decades. Table 2.22 shows that the share of all non-institutional agencies sharply declined by about 36 percentage points during the period 1971-72 to 1981-82. During this period, the share of almost all categories of non-institutional agencies showed a fall – the decline being 8 percentage points or mor e for moneylenders (agricultural or professional) and traders. The decade ending 1991-92 also saw a marginal fall of about 2 percentage points in the combined share of the non-institutional agencies. However, there was a 9 percentage point increase in the combined share of professional and agricultural moneylenders during 2002-03. Among the non-institutional agencies, a significant rise of more than 7 percentage points in the share of professional moneylenders during the 1990s is worth noting. Relatives and friends accounted for about 7 per cent to 12 per cent of total household borrowings throughout the two decades under study.

Conclusion

The analysis of indebtedness among rural households shows that about half of them were in debt and three-fifths of their debt was owed to institutional sources. Of the total debt of about Rs.1.12 lakh crore in 2003, Rs.48, 000 Crore was sourced from non-institutional agencies. Of which Rs. 18,000 crore of debt carried an interest rate greater than 30 per cent. There is a need to relieve the farmers from private debt carrying high interest rate by transferring it to institutional agencies. Farmers' indebtedness was strikingly a regional phenomenon; it was low in less developed states. In all states which had reported suicides among farmers, the incidence as well as debt per farmer household was high. However, sources of debt varied. For example, in Maharashtra, the major source was institutional agencies, whereas in Andhra Pradesh, non-institutional agencies accounted for bulk of the debt. This suggests that while formalization of informal debt is an important step in reducing debt burden of farmers, other measures to ensure assured income from farm and non-farm sources are equally essential

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