

CHAPTER 2-4 : RURAL CREDIT AND THE COLLATERAL QUESTION

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Two questions are considered in this chapter. One concerns the role of state-regulated or formal credit in the rural economy. It can be explored through the evolution of the policy agenda and through access in the villages. We can then use village studies to address a specific policy question. Given moves to deregulate credit and remove subsidies should the state target concessional credit to small, marginally landed and landless producers for the express purpose of purchasing land. We call this the collateral question. In other sectors of the economy, notably food distribution, attempts to drop general subsidies have been accompanied by the protection of subsidies to vulnerable people. The collateral

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question is consistent with these trends in India's economic reforms.

1. STATE REGULATED CREDIT

1.1. The Context : Waves of Rural Credit Policy

State regulated rural credit was originally justified by a set of developmental objectives : the need to displace informal finance ¹on the grounds of the kind of

¹1. The informal sector is a catch-all category comprising village or 'local' moneylenders, pawnbrokers, friends and relatives, landlords and traders, typified by personalised contacts and by the lack of bureaucratic procedures and written agreements, other than written bonds or 'promissory notes' which are unstandardised but stamped documents hovering between formal and informal sector because they can be brought to court within 3 years of the latest date (Olsen and Rani, 1997, p.19).

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monopolistic and exploitive practices excoriated in the **All India Rural Credit Survey** of 1954: the need to penetrate regions as yet thinly and imperfectly provisioned with credit, the need to counter the concentrated, oligopolistic and thinly dispersed character of private banking and to encourage a wider social dispersal of increased incomes in order to achieve higher levels of output and growth (Sarap, 1991, Kohli, 1999). The instruments of this 'needs-based' credit policy are very well known:

* state ownership of fourteen banks (nationalised in 1969);

It is also termed 'non-institutional credit' (Janakarajan, 1986). Formal credit (institutional credit) is based upon impersonal written documents accepted in a court of law and used by commercial banks, Land Development banks and Co-operative Societies.

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- * segmentation among banks (Co-operatives, (for rural short term credit), Land Development Banks, Nationalised Banks (for urban long term credit), commercial banks);
- * refinance from the IMF and World Bank by means of the National Apex Bank for Agriculture and Rural Development (NABARD);
- * spatial and sectoral targets (organised by Lead Banks) with differentials in interest rates;
- * quotas for credit disbursement on concessional terms (e.g. 40 per cent of credit directed to priority sectors and 18 % to agriculture) and
- * regulation under the Banking Regulation Act by the Reserve Bank of India.

In the early eighties (given the failure of poor people to gain access to formal sector credit and that of the seed-fertiliser-water technology to diffuse to the social base or to regions of rainfed agriculture and provide widespread

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employment or real wage increases), the Integrated Rural Development Policy (IRDP) was inaugurated to alleviate poverty by means of credit for non-land assets endowments. Forty per cent of IRDP loans were supposed to be targeted at women (Copestake, 1992). These layered policies endured into the 1990s, when they were threatened by a battery of theoretical critiques and refinements, policy changes and critical evaluations of the way they had been implemented.

While the reduction in the general distance between people and banks helped to raise the share of rural deposits (savings) from 3 per cent in 1969 to 15 per cent in 1996 (Kohli, 1999) and a quantitative expansion in formal credit took place at the expense of private moneylender-credit (from 7 per cent in 1951 to 63 per cent in 1981),² 'the quality of lending' deteriorated (Gadgil, 1992). The structure of

²2 . This information is from RBI reports summarised in Olsen and Rani, 1997.

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credit policy contained its own debilities. First, formal sector administration costs were higher than those of the informal sector. Second, interest rate ceilings not only reduced incentives to save, they reduced incentives both to repay and to recover loans (Hoff and Stiglitz, 1990), so that overdues increased. Third, the recovery process was also vulnerable to the power of agricultural interest groups at elections and dotted with loan waivers and write-offs (Rao, 1994, pp. 307-8;

According to Hanumantha Rao this expansion has been led by the Commercial Banks which have increased their share of the formal rural credit market at the expense of the co-operative network (1994, p. 307). According to NSS data, by 1981 the share of moneylender credit was as low as 16 per cent but the estimate is disputed (Bell, 1990 quoted in Binswanger and Khandker, 1995 p. 257). This argument about one form of private moneylending deflects attention from the quantitative importance of the informal sector as a whole.

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Olsen and Rani 1997; DrPze, Lanjouw and Sharma, 1998). Fourth, the profitability of dispersed rural banks had been acutely sensitive to the competence of management (Kohli, 1999).

Be that as it may, an econometric study at the All India level of the returns to state-regulated agricultural credit from 1972-3 to 1980-1 shows (on generous assumptions) that the policy led to '**modest increases in aggregate crop output**'; sharp increases in the use of fertilisers and in investment in physical capital and substantial **reductions in agricultural employment**' (our emphasis). The net additional agricultural income exceeded the cost to the state of its agricultural credit policy by 13 per cent (Binswanger and Khandker, 1995, pp. 253, 258).

Other criticism had also alerted policy makers to the 'multiplier effects' of their credit. The assumptions about the directibility of credit were exposed as naive.

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First, formal loans were fungible (directly or through onward lending for unintended and unsupervisable purposes - notably 'consumption' for which the formal sector is prevented from lending (Swaminathan, 1991)). Second, rationed credit was captured by agrarian elites by means of its prohibitively high transactions costs (which repelled small producers) and rent-seeking by bank officials (which screened small producers out) (Sarap, 1991).³ By the late eighties, 60-70 per cent of rural credit was going to farmers owing in excess of 5 acres (Rao, 1994, p. 307). Binswanger and Khandker quote Rath (1987) to the

³3 . A large literature reviewed by Olsen and Rani, 1997, concludes consistently that small farmers have been excluded from formal credit. With rare exceptions in cases where state credit reduced the inequality of control over resources - as in West Bengal (Bhattacharyya, forthcoming) - state directed credit was doing the opposite of what was stated to be intended.

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effect that 'only about a quarter of cultivators borrow, and long-term loans are received by no more than two per cent. The majority of small cultivators have little access to credit' (op cit, p. 257). Presumably this referred to formal credit, because Rao has evidence for the mid eighties showing that producers with assets under Rs 10,000 obtained between 68-90 per cent of their credit from informal sources (Rao, 1994, p. 310). It is nevertheless hardly surprising that the **indirect** impact of state-regulated credit is found to be significant: an elasticity of 0.24 in **non-agricultural** employment over the first 10 years of agricultural credit expansion (ibid).

The anti-poverty thrust of IRDP got ambivalent reviews: on the one hand, 57 per cent of beneficiaries received incremental incomes of Rs 2,000 plus and a similar percentage were heaved over a very conservative poverty line. On the other hand, 43 per cent of borrowers were 'wilful defaulters' and effectively received a

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politically motivated grant, which had knock-on effects on other loan repayments to the 'formal' sector.

As the directed credit policy consolidated itself, another 'deformity' came to light, which is the backcloth to our village study. This is that the southern states grew to be relatively oversupplied with directed credit. By 1985, the southern states with 19 per cent of India's total cultivated area had 28 per cent of bank offices, 44 per cent of directed agricultural credit, average loan sizes over twice bigger than those in the eastern region and 73 per cent of the outstanding debt. What is perhaps less well known is that Tamil Nadu (though better supplied with banks and credit than elsewhere in India) bucked this trend. It was the only one of the southern states to see a *decline* in the percentage of short term loans supplied by the formal sector between 1973 and 1985 (Desai, 1993; Rao, 1994, p. 337).

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As late as the time of our field survey in 1993-4, it was still possible to write that the impact of India's credit policy on the informal credit market was unknown (Rao, 1994, p. 308); attention had shifted so markedly to the formal sector. Two influential evaluations, the Khusro Committee (reporting in 1989) and the Narasimhan Committee (in 1991/98) concluded that wide ranging reforms to rural credit were overdue : interest rates on loans and deposits should be market-determined, subsidies to private capital cut, rural banking deregulated, concessional targetted credit be confined to small and marginal farmers (**Khusro**) or increased in scope to include (private/regional banks in) a wide range of activities in rural marketing and the non farm sector (**Narasimhan**). Meanwhile the Reserve Bank of India continued to regulate such parameters as interest on deposits and loans, the capital/asset ratios of banks, directed credit (but less ambitiously than before) and reporting requirements. Private and international banks have expanded operations and work on (global) commercial principles

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(Kohli, 1999). The policy debate between deregulation (responding to the structural weaknesses of formal credit by abolishing it) and reform (responding to its problems by lowering transactions costs and administration, changing incentives, widening scope and experimenting with new forms (particularly with micro-credit and group credit)) continues unabated (Johnson, 1999).

1.2. Evolving Credit Relations in the Region

Just as the region has been dominated by paddy production, so the credit market has been dominated by personalised contracts between paddy traders and producers, interlocking money and product markets. Informal lending long predated state involvement. J. Harriss (1982) argued, from conditions in the early seventies, that traders' credit was crucial in financing the agricultural cycle which reproduced the small peasantry. B. Harriss (1981) concluded that the interlocked contract enabled the rates of profit from trade greatly to exceed that

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from production proper. Further, foreclosure on the fragmented land plots which supplied collateral for overdue loans was unattractive to traders on grounds of the transactions costs of taking over ownership and the supervision costs of production thereafter. So petty production was maintained by traders and the development of capitalist land relations was constrained. In 1973, formal credit was underdeveloped - a mere 12 per cent of the total volume of credit in 11 randomly selected villages.

A decade later, in the heyday of directed credit and IRDP and the state's sustained attempt to disperse petty capital formation, the thesis that traders' credit reproduced small scale production was jettisoned (J. Harriss, 1991). While traders' credit certainly remained important (the data actually does not identify **traders'** credit, but in 1983 'informal credit' still amounted to 53 per cent in the three villages we resurveyed in 1993-4), formal credit had expanded to 42 per

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cent of debt, of which IRDP made up between 6-15 per cent. J. Harriss found that the great majority of producers had a permanent personalised relation with a paddy trader, but that, while the contract was still an important means of syphoning resources away from agriculture, an element of option had entered the relationship because of the existence of alternative sources of credit. These alternatives were thought to have contributed to a decline in usury (also noted in Athreya et al's research much to the south (1987))⁴ And were part of a much wider trend of increasing agrarian dependence upon the state.⁵ The state had

⁴4 . Interest rates in the informal sector were a 'modest 24 per cent'. A minimum of 12 per cent was 'not at all unusual' while the maximum , 60 per cent, was exacted from small loans using vessels or jewellery as collateral and pledged for short periods to village moneylenders (J. Harriss, 1991, p. 77).

⁵5 . Also manifested in electricity, the public distribution system and fair price

replaced grain traders in supplying the means whereby the process of differentiation through land relations could be constrained. Yet it would not actively allow IRDP credit, or any other loans, to small or landless peasants for the purchase of land.

A decade later, the story, which we will tell more fully, twisted again. Our data comes from village diaries, from census information collected in late 1993 and the detailed follow-up survey of 1994 which concerned the previous agricultural year. In this study the detailed data for **loans taken out** ⁶ in that year alone are analysed. Households took out up to four loans per season, for each of the three

shop network, the Noon Meal Scheme and the IRDP (J. Harriss, 1991, p. 78).

⁶ . We are not examining moneylending within these villages.

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seasons. To make this research directly comparable with others', credit is analysed according to assets ownership groups.

1.3. Local Planned Credit

In 1993-4, the year of our study, some Rs 77 crores of state regulated credit was available for Tiruvannamalai-Sambuvarayar District. This money was very highly directed with physical or financial targets, as appropriate, for every bank and for every one of 66 government schemes. The region we study was remarkable on an All-India scale for the share of its formal sector loans to the priority sector. At 85 per cent, this was double the 40 per cent national target! (Indian Bank, 1993, p. 1.9). The latter, in any case, had not been achieved during the 1991-6 period of the 8th Plan (Kohli, 1999). The share of formal loans allocated to 'weaker sections' (Scheduled Castes and Tribes), at 36 per cent, was also considerably above the national average and target. But loans outstanding

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were also double the target! While targets for agriculture in general, for biogas and other state schemes were reached over the period 1990-92, they mask **underachievement by commercial banks and overachievement by nationalised banks** (op.cit. p. 2.6). Short-term agricultural production loans are dominated by the finance of sugar cane and other commercial crops quite disproportionately to the number of producers and are biased particularly away from groundnuts but even away from paddy/rice (Table 1). **The components of overachievement are not agricultural** but in ‘artisanal’ activity, small scale industry and most notably ‘trade and services’. Loans for rural industrialisation doubled in the early nineties - but from an extremely small base to 7 per cent of formal loans. Loans specifically for **trade** were targetted at some 20,000 borrowers - four times the number for non-farm production. **Lending is trade-heavy**. Around Arni, Rs 7.2 crores were available for lending, of which, government grants amounted to Rs 1 crore.

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Table 1: Crop Loans, 1991-2 (Rs Lakhs)

	Accounts		Loans	
	n	%	n	%
Crop				
Paddy/rice	69823	43	761	32
Groundnut	52785	32	309	13
Sugarcane	27490	17	898	38
Other (Comm. Crop)	13079	8	384	16
TOTAL	163177		2352	

Source: Indian Bank 1993, p. 2.4.

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1.4. Moneylending in the Villages, 1993-4

Before we turn to the survey data, there is much to be learned about credit in the three villages which is completely invisible from the conventional and bland form in which the data set have been coded for analysis. For the colour, the field investigators' village diaries are invaluable. These reveal a huge range of uniquely combined credit arrangements in each village.

Vinayagapuram: This is a remote but developed agricultural village with a relatively egalitarian landholding structure. Dominating the informal credit arrangements of this village is a family-based moneylending cascade controlling about Rs 3 lakhs. The patriarch, a landed moneylender, services about 30 cultivators with loans of up to Rs 20,000 on the basis of promissory notes and jewels, at 24 per cent interest. Three sons lend to a further 45 people. Their

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wives lend to about 30 women sums of up to Rs 200 on the security of household articles and at 60 % annual equivalent interest. Their sons lend small sums (up to Rs 500) on the same basis. All borrowers are described as 'friends'. Then there are two female moneylenders, plus a grocer and teashop keeper who lend on the basis of watches, clocks, cycles and pledged ration cards, mainly to Scheduled Caste borrowers at an interest reflected in the discounted price of rationed commodities. Next there is one particular urban pawnbroker lending money at 24 to 36 per cent on gold and jewels, together with 5 urban paddy traders and rice millers who habitually service this village with preharvest advances of up to Rs 750 and repayment either in cash (at 24 per cent) or in kind (at an equivalent deduction). These, together with a large silk merchant and certain smaller ones, tie the loans to the purchase of agricultural inputs or groceries sold by particular urban traders. So there is a tight nexus of mercantile credit connected through interlocking triadic contracts. These lenders will also lend for the purchase of

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land and other long term purposes. These are the lenders who over the last decade have come to employ ‘agents’ to enforce repayment. The latter in turn use village elders and the authority of the village panchayat to press threats. Farmers in nearby villages also lend, on bonds at 36 %, sums up to Rs 50,000 to the bigger farmers in Vinayagapuram. The latter lend onwards on the same terms and conditions to poorer borrowers for the expenses connected with paying labour, consumption, illness and death. Mercantile and agricultural moneylenders are all able and willing to take land in cases of default.

There are three seasonal rotating credit funds (**chit funds**) run by and for richer farmers in and near the village. There are two further chit funds for small peasants and weavers, one when the total take is auctioned at full moon and one at new moon. Scheduled Caste people have three chit funds, a dual purpose one, the net interest of which maintains a temple, one for female agricultural labourers

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and a third which auctions up to Rs 20,000, run by a woman teacher. Two further chit funds are used to subsidise annual pilgrimages. A bunk shop owner organises two more chit funds, one of which also fuels the ruling political party. Recently deceased are two important figures, a landed **brahmin** moneylender who had his own Scheduled Caste ‘police force’ and a **chettiar** living nearby for whom moneylending started as a side business to carting paddy.

Here we see various axes of segmentation: gender, caste, locality and class. We find moneylending interlocked not with other ‘markets’ so much as with specific individuals operating in different markets. We find lending not only interlocked with product markets but also with redistributive activity connected with religious observances. We see ‘access to urban credit’ meaning access to specific urban intermediaries. We see an increasingly organised process of repayment which is developing out of relations of authority based on threats to third party

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interests into sets of physical enforcers who operate through local political parties as well. Money markets are interlocked with party politics. We see at least a dozen rotating credit funds, the striking feature of which is the social homogeneity of their membership.

Nesal: Nesal is a large, periurban, diversified village with a very unequal structure of property relations. Its system of grain traders' and silk merchants' lending and chit funds is similar to that of Vinayagapuram. Nesal has some unique features too. First there is an itinerant moneylender who arrives on thursdays, a **gounder** by caste, who lends to up to 150 people in Nesal petty sums below Rs 100. Interest of 3% is deducted at source and a further 25% interest has to be paid along with the principal over 10 weeks - annualised at 140%. This man prefers to lend to women, whom he reckons to be 'sober and compliant'. Two wives of major landholders lend foodgrains to landless women

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at 12%. Three other female **yadhavas** and **mudaliars** (agricultural castes) specialise in **‘siruvadu’** - small loans of up to Rs 300 with vessels, utensils and earrings as collateral, with annualised interest varying from 60 to 120% and with the capacity to confiscate security. These women are said to have got their starting capital by diverting small streams of their husbands’ loans from ‘Operation Flood’ from cattle-feed to chit funds. Another woman operates 4 different chit funds among female milkers of cows, whose ‘takes’ range from Rs 1,000 to Rs 10,000. Again she characterises female borrowers as compliant and unviolent.

Although the survey data reported in the next section suggests that **women, who are heads of the households, are at extreme disadvantage as borrowers**, the material from Nesal suggests that there **is a concealed but thriving sector of petty borrowing which is gender specific and female.**

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Veerasambanur: Veerasambanur is a small, remote, undiversified, poor yet unequal village. The village is close to an active agricultural co-operative bank at Thaccambadi, the only formal sector source of credit actually mentioned in the village diaries. In addition, the local Christian church provides grants of money for small livestock to a Womens' Group in the village.⁷ There are three village moneylenders, none of whom have the reputation for force but all of whom have purchased land and invested in rice mills or other property as a result of moneylending. Then come two rural and two urban grain traders who work with promissory notes thereby tying loans in kind to particular traders. A group of 6 peasants and 2 landless labourers operate a seasonal chit fund - '**boga cheetu**' -

⁷7. It also operates a food for work scheme giving labourers food in return for well deepening and desilting of channels.

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and among the Caste households can be found another chit fund, the net proceeds of which maintain one of the four village temples. Four women pawnbrokers operate from the village and four specific pawnbrokers are patronised in town. In this way, quite poor peasants pawn brass vessels, silver anklets and such like for money to pay agricultural labour. Finally, there is '**kanthu vaddi**' which is loosely translated as 'kicking in the back while running, and snatching away'. These lenders are outsiders and the arrangement is reported as comparatively new.⁸ Their clientele is about 40 Scheduled Caste agricultural labourers who borrow for routine lean-season and/or urgent and unforeseeable consumption purposes. Sums of up to Rs 200 are lent, 12.5 per cent being retained at the start and the rest repaid over 10 weeks at interest which can be annualised (without risk of exaggeration) at 125 per cent, together with a deduction of up to a further

⁸8 . **Kanthu vaddi** is also known in Vinayagapuram.

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35% on the prices of goods in kind, if payment is not in cash. Collateral takes the form of work pledges by female relatives. Debt levels of Rs 1,000 or more can build up quite quickly. When payment becomes irregular, durables are seized.

Here we see certain common patterns, including the high frequency of small loans and a classic, Bhaduri-style, deployment of interest to bring about default (Bhaduri, 1983). We also find collaterals distinct from articles seized (and authority derived from the general reputation of kin rather than the personal particularities of the borrower) which we will try to explain later. In addition, we find general reputation (Scheduled Castes as drunkards; women as docile and biddable) powerful in the segmentation and fracturing of ‘markets’ in money.

DrPze et al (1998) argue that the key characteristics of village lenders are not their monopoly position so much as attributes such as wealth, caste, age, relative

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		Source of Credit				
Village		Formal only	Informal only	Both	No loan	Total
Nesal		2.77%	62.86%	9.85%	24.53%	100.0%
Vinayagapuram		0.00%	47.24%	15.75%	37.01%	100.0%
Veerasambanur		6.94%	55.80%	19.61%	17.65%	100.0%
All Villages		2.56%	56.04%	13.74%	27.66%	100.0%

Note: 115 households (for a total of 230 observation and 200 new loans)

Formal, or institutional, sources of credit are: Co-operatives, Commercial Banks, Land Development Banks, IRDP & Other Govt. sources

Informal sources are: Moneylenders & Pawnbrokers, Traders, Silk Merchants & Weavers, Friends & Relatives, Shopkeepers and Other.

While very few indebted households confine borrowing to the formal sector, 70%

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of households borrow from non-state-regulated sources. Nesal has the highest proportion of households borrowing from informal sources (65%) and the lowest proportion of households taking loans from both formal and informal institutions. Vinayagapuram has the highest percentage of unindebted households (37%), while Veerasambanur has the largest percentage of households borrowing from formal sources (20% in conjunction with informal borrowing). However these shares are sensitive to the populations of the villages. In fact there are 13-14 people with formal loans in each village - every bit as though there were a standardised target. Although the percentages of households which do not borrow and which borrow from formal or informal institutions are not exactly the same between villages, debt relations follow a common pattern.⁹ A very small

⁹9 . The Pearson tests of independence for a two way contingency table, in this case equivalent to the test of homogeneity of rows, could not be rejected.

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percentage of households take loans from formal institutions alone, whilst the great majority of borrowing households only borrow from informal sources. Between 10 and 20% of households take both formal and informal loans while, on average, 28% of households do not borrow at all.

1.5.1. The Social Profile of Access to Credit

Table 3 maps access to credit on to the social characteristics of caste, gender and education (see Chapters 1-4 and 1-5). About 78% of Scheduled Caste households (SCH) and about 67% of those households whose head is illiterate (IH) are indebted. By contrast, more than half of the households headed by women (FHH) do not borrow at all. Not all FHH are poorly asseted; the richer minority may be self-sufficient non-borrowers rather than being excluded potential borrowers (which is what we suspect for the majority). **The access of all kinds of socially disadvantaged households to formal credit is extremely**

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constrained. FHH only borrow from informal institutions (moneylenders, friends and others). Only 2 per cent of SCH and 7 per cent of IH borrow from formal sources (either form only formal or from both), which contrasts very strikingly with the 25% of households belonging to other castes and the 23% of ‘literate’ households.¹⁰

¹⁰10 . i) of course not all members of households with a literate head are to be presumed literate; ii) this contrasts with Olsen and Rani’s research (1997, p. 36) nearby where they found that caste was **not** a good predictor of access

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Table 3 : Social Characteristics of Borrowers: 3 villages.

	Source of Credit				
Social Characteristics	Formal only	Informal only	Both	Loan	Total
Gender					
Female Headed Hhs		44%		56%	100%
Male Headed Hhs	3%	58%	16%	23%	100%
Caste					
Scheduled Caste	1.74%	74.19%	2.20%	21.87%	100%
All others	3.12%	43.88%	21.46%	31.54%	100%
Education					
Illiterate Hh head	0.96%	59.98%	5.91%	33.14%	100%

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Literate Hh head	3.67%	53.32%	19.14%	23.88%	100%
All	2.56%	56.04%	13.74%	27.66%	100.0%

Note: 115 household (for a total of 230 observation and 200 new loans)

Access to the formal sector varies directly with land holding while the relation to the informal sector is inverse (see Table 4) . While all households with over 5 acres are indebted, between 20-48% of those with less than 5 acres including the landless did not borrow over the period of the survey. **Land secures access to the formal sector.** While 85% of households with more than 5 acres get state-regulated loans, a mere 6% of those with under 0.1 acre and 3% of landless households do. **In fact, it is a threshold of 5 acres that enables access to the formal sector to approach an entitlement,** a factor masked in the landholding classification of Hazell and Ramasamy (Table 5) as well as in our cluster

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analysis (Table 6). ¹¹

Table 4 : Landholding and Access to Formal and Informal Credit

	Source of Credit				
Land size groups	Formal only	Informal only	Both	No loan	Total
Landless	1.9%	64.6%	2.5%	31.0%	100%
Marginal	0.0%	67.8%	5.9%	26.3%	100%
0.01-1.00 acres					
Small	2.7%	66.2%	10.9%	20.3%	100%

¹¹11 . Similar findings are also reported by Sarap (1988, 1991), Kochar (1997) and Rao (1994).

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1.01-2.50 acres					
Medium	6.2%	18.4%	32.4%	43.0%	100%
2.51-5.00 acres					
Large	7.5%	7.5%	85.1%	0.0%	100%
>5.00 acres					
All	2.56%	56.04%	13.74%	27.66%	100.0%

Note: 115 household (for a total of 230 observation and 200 new loans).

1.5.2 Flows of Money

Formal credit had apparently **shrunk** as a proportion of total credit by 18% over the decade form 1983-4. Despite decades of developmental offensives by state-regulated credit institutions, 61% of money borrowed was ‘informal’ in 1993-4. Average formal loans varied from Rs 6,445 to Rs 8,769 according to the village, while informal loans varied from Rs 1,573 to Rs 3,832. Half the volume

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of informal credit emanated from agricultural product traders and silk merchants. It exceeded the volume from all state sources (see forward to Table 8).¹² Credit relations were reverting to the forms taken in the first phase of the green revolution while by the nineties the wage labour force had been greatly expanded. This had the effect that a much larger proportion of the population was excluded from credit requiring land as collateral than was the case in the seventies.

Village credit was strongly socially niched. **Female headed households, which constitute 14% of the sample**, only took 5.5% of the total number and **1.8% of**

¹²12 . This contradicts J. Harriss's conclusion that the balance had shifted to the state (1991) but is consistent with estimates for the relative roles of a formal and informal credit in rural Andhra Pradesh by Olsen and Rani, (1997, pp. 25-6).

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the total volume of loans. None of these loans came from formal sources. The average debt for a female headed household was Rs 1,549 in contrast to Rs 7,766 for male headed households. **Scheduled Caste households formed 40% of the sample** and although they borrowed a proportional number of loans, their share of the total flow of borrowings was only 13 per cent. The average size of formal loans did not differ by Caste status but **only 8.5% of this credit** (whether in number or in volume) went to Scheduled Caste households. The average loan size was much lower than that for households of other castes - at Rs 2,227 and Rs. 11,061 respectively per borrowing household.

Considering literacy as a categorising variable, **IH on average took lower and smaller loans.** Whether borrowing from formal or informal markets, the average size of a loan was always lower than that taken by a literate household. Almost 90 per cent of the total amount of credit borrowed by illiterate households came

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from informal sources, while literate households relied on formal institutions for 44 per cent of the total volume of loans they took.

Table 5: Access to Formal and Informal Credit According to the HR Classification.

	Source of Credit				
Farm Size (HR)	Formal only	Informal only	Both	No loan	Total
Large	7.2%	29.2%	44.9%	18.8%	1000%
> 1 hectare					
Small	1.6%	68.1%	10.3%	20.0%	100%
< 1 hectare					
No farm	1.5%	56.9%	4.5%	37.1%	100%

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All	2.56%	56.04%	13.74%	27.66%	100.0%
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Note: 115 household (for a total of 230 observation and 200 new loans).

Table 6: Access to Formal and Informal Credit by Class.

	Source of Credit				
Cluster	Formal only	Informal only	Both	No loan	Total
Elite	7.9%	17.0%	56.5%	18.5%	100%
Middle with land	0.0%	54.5%	19.7%	25.8%	100%
Middle landless	0.0%	74.4%	0.0%	25.6%	100%
Poor with land	5.2%	57.4%	12.5%	24.9%	100%
Poor landless	1.9%	62.2%	2.5%	33.4%	100%

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All	2.56%	56.04%	13.74%	27.66%	100.0%
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Note: 115 household (for a total of 230 observation and 200 new loans).

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Table 7: Class, Landholding and Loan Sizes.

			Landholdi ng					Cluster			
			Landless	Marginal	Small	Medium	Large	Poor landless	Poor with land	Middle landless	w
% of H o u s e h o l d s			36,01%	22,49%	21,92%	14,31%	5,26%	36,65%	20,71%	9,26%	
% of tot al bo rrro			34,4%	22,9%	24,2%	11,3%	7,3%	33,7%	21,5%	9,5%	

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% of Total Loan volumes:		12,2%	19,8%	16,5%	15,9%	35,5%	11,3%	16,9%	9,3%	
Average		1225	2731	2126	4085	10868	1231	2491	2630	

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e L o a n si ze (R s)										
F or m al L o a ns (R		4792	4267	5810	4911	13926	4792	5425		

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	s)									
		% of formal loan number within groups (col sum)	4,41%	5,06%	7,30%	58,81%	44,76%	4,79%	11,99%	.
		% of formal loan volume within groups (col sum)	17,26%	7,91%	19,95%	70,71%	57,36%	18,66%	26,11%	.
		% of formal loan number between groups (row sum)	8,6%	7,2%	11,1%	44,7%	28,5%	8,6%	15,8%	.
		% of formal loan volume between groups (row sum)	5,5%	4,1%	8,6%	29,2%	52,8%	5,5%	11,4%	.
In	fo		1061	2649	1836	2905	8389	1051	2091	2630
r	m									
a	L									
o	a									
ns	(									
R	s)									
		% of informal loan number within groups (col sum)	95,59%	94,94%	92,70%	41,19%	55,24%	95,21%	88,01%	100,00%
		% of informal loan volume within groups (col sum)	82,74%	92,09%	80,05%	29,29%	42,64%	81,34%	73,89%	100,00%
		% of informal loan number between groups (row sum)	35,3%	25,5%	26,7%	5,9%	6,7%	32,4%	22,0%	13,1%
		% of informal loan volume between groups (row sum)	16,5%	29,7%	21,6%	7,6%	24,7%	15,0%	20,3%	15,2%

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% of B or ro w in g h o u se h ol ds		69,03%	73,72%	79,75%	56,96%	100,00%	66,60%	75,09%	74,39%	
A v er a g		2527	6251	4951	10220	35291	2427	5679	7072	

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e L o a n a m o u nt (p er b or r h h)										
A v er		2,1	2,3	2,3	2,5	3,2	2,0	2,3	2,7	

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a g e L o a n n u m b er (p er b or r h h)										
A		1779	4608	3949	5821	35292	1617	4264	5261	

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er a g e L o a n n u m b er (p er h h)										
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Note: 115 household (for a total of 230 observation and 200 new loans)**1.5.3 Economic characteristics of borrowers**

Credit is disproportionately concentrated among the assetted (Table 7).¹³ Here, of the total amount borrowed, only **12% goes to the third of households which are landless**. The debt of households with in excess of 5 acres is 10 times that of the landless. **Medium and large landholders** (more than 2.5 acres), accounting for less than **20% of the sample, obtain more than 50% of the total volume available. The inequality is even more pronounced for formal credit.** Landless households and those with only a marginal extent of land (58%), obtain less than 10% of credit disbursed by formal institutions. More than 50% of formal credit is taken by the 7% of households holding above 5 acres of land.

¹³13 . Similar findings have been reported by DrPze (et al 1998), Sarap (1988, 1991), Kochar (1997) Rao (1994).

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The possession of a micro-holding (0.1 to 1.0 acre) enables households to double the size of their loans over those of the landless with equivalent incomes (from Rs 1,225 and 2.5 months income equivalent to Rs 2,700 and 6 months).

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Table 8: Source of Money by Social Characteristics

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Friends and relatives are the only sources of money geared to the poor, but in contradictory ways. Some loans, at 22% interest, are indistinguishable from commercial ones, others (at an annualised average of 6%) operate according to a logic of reciprocity. Most of the debt of marginal and small peasants is from traders of one sort or another such that kind repayment interlinks two 'markets'. **About half of the pawnbroking credit and three quarters of silk merchants' loans go to the agricultural and weaving households of the middle peasantry and 60% of agricultural traders' credit goes to the agrarian elite.**

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Table 9: Sources of Money by Economic Characteristics

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With the exception of IRDP, the retrogressive role of formal institutions is highlighted in Table 9. ¹⁴ Even the anti-poverty IRDP loans ¹⁵ went to men, all to literates. Half the IRDP loans (but 37% of the volume) went to Scheduled Castes. Two thirds of IRDP funds found their way to poor peasants with land. The exceptionally rare cornering of Land Development and Co-operative credit by poor peasants was diverted by them for consumption. Again **the possession of a small amount of land is seen to give poor peasants access to a wider range of state-regulated markets for money.** Commercial bank and co-operatives, which provide 85% of all formal credit, supply their loans essentially to the rural elite, exactly as does the bulk of informal credit.

¹⁴14 . DrPze et al (1998) conclude similarly for Palanpur.

¹⁵15 . For cattle, carts and land improvement (well digging).

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1.5.4. The Use of Credit

A third of the torrent of credit is for subsistence, 60% for production and 7% for refinance (Table 10). Credit institutions allocate funds distinctively according to their intended purpose. **Formal credit is predominantly supplied for productive purposes and essentially for agriculture.** Although the average size of a loan does not vary much with its purpose, only 13% of all formal loans are issued for consumption, and then mainly for the purchase of durable goods (usually for house purchase or renovation). Informal credit is less dedicated. Most informal sources give credit for subsistence, for the acquisition of durables, for the costs of health and education, and for ceremonial expenditures. Loans

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taken from friends and relatives are principally used for consumption (particularly for health and education). Moneylenders, pawnbrokers, silk merchants and master weavers also provide significant volumes for consumption. The difference in the average size of consumption loans between the two groups is partly explained by the fact that the former group of lenders gives a large number of small loans for domestic consumption to agricultural producers, while the latter mainly provides loans of larger size for durable goods and the consumption of weaving households.

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Table 10: Credit by Intended Purpose

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Table 11 describes the use of funds according to the two classifications of landholdings and class clusters. The poorest peasants, landless households and those who do not cultivate their land use the great bulk of their borrowings (between 83-89% of the number, and between 60-70% of the volume of loans taken) for consumption. A small sector of petty landed proprietors incur sizeable debts for refinance. To see the difference to credit behaviour made by a small quantity of land we can compare the poor landless and poor landed clusters. **The poor landed have double the debt of the landless and the proportion used for productive purposes rises from 24% to 38% of the volume, that is by nearly 60%.** We see the same relation in the fine grained landholding classification: a rise from 26% among the landless and marginal to 40 per cent among smallholders, itself an increase of 85%. **The possession of one acre marks a significant change in the use of credit.** In contrast, the elite of the villages, the medium and large landowners, allocate most of the loans to production. Even so,

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when the elite borrows for consumption the average loan is Rs 10,000, and equivalent to twice the annual income of an agricultural labouring household. Credit is an income smoothing insurance for those without assets while it is a factor of production for the rural elite.

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Table 11: Use of Credit by Economic Characteristics

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2. THE COLLATERAL QUESTION

Collateral is the means by which borrowers gain access to finance with which to create future wealth (even when used for smoothing contingent dips in income streams) and the means used by lenders to screen (so as to reduce default risks), to share risk and to compensate for default. But of course collateral is productive in its own right (though certain types of collateral are hardly ever theoretically recognised as productive because they take the form of poorly specified future promises or (like utensils) are productive in the unvalorised domestic sphere of the rural economy).

Land is found to be the most widespread form of collateral in the agrarian

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economy.¹⁶ Land affects both the supply of, and the demand for, credit.¹⁷ The collateral role of land may determine the supply of credit to its owner. After a certain point, its collateral capabilities may be outweighed by the substitution effect on the demand for credit of income generated directly by it, after which

¹⁶16. See Jodha, 1971; Binswanger and Rosensweig, 1986; Sarap, 1990.

¹⁷17. Higher informal sector interest may have less to do with collateral than to spill-over from rationed supply in the formal sector (Acharya and Madhur, 1983) or alternatively from the abundance of formal credit which shifts the high cost/ high risk borrowers, concentrating them in an increasingly residualised informal sector (DrPze, Lanjouw and Sharma, 1998).

point, demand for credit is reduced (Bhende, 1986; Swaminathan, 1991). For smallholders, land is a problematic collateral because a) they have little and b) they are risk averse about what little they have, because of its centrality to their livelihoods. So the collateral offered by small holders also takes non-land forms: status in terms of access to water, commitments of future labour or crops, utensils, gold, third party guarantees or reputation underwritten by kinship (Janakarajan, 1986; Sarap, 1988). The fact that the formal sector discriminates against such collaterals restricts credit access by their owners to non-state-regulated lenders in the informal sector. Higher informal sector interest both reduces supply because of the increased probability of default, and reduces demand because higher risk activity tends to be screened out (Braverman and Guasch, 1986). Swaminathan (1991) discovered, however, that interest was not so much related to risk but instead was inversely related to the marketability of collaterals. Well-commercialised land was associated with lower informal

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interest. Gold and jewels were poorly commercialised and the highest interest was demanded on brass vessels and promissory notes which were hardly commercialised at all.

If landless and currently marginal landholders were able to purchase land, their collateral base would broaden, enabling access to the formal sector, reducing interest rates on credit and redistributing a productive asset in conditions where the draconian preconditions to successful pro-poor land reform are absent.

2.1. Collateral in the Villages

Over 75% of the loans observed amongst the household borrowers surveyed were secured with some sort of collateral. Although based on a small sample of only 200 loans - which has to be treated with caution - Table 12 reveals patterns in the

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role of collateral.¹⁸ Formal institutions rarely supply loans without collateral. Land and gold are the sort of collateral most commonly required by state-regulated co-operatives and commercial banks, although other types of collateral, such as future crop and bonds are also accepted. Indeed, land was the basis for only half the formal loans. Loans offered by Land Development Banks had been secured either with land (in 62% of instances) or with personal reputation (for the other 38%). By contrast each informal source accepts a wide

¹⁸18 . All of the 32 loans from co-operatives, commercial and land development banks were secured by collateral. There were 3 IRDP loans, one of which was given to a poor landless peasant without collateral in order for him to purchase a ploughing bullock (although the loan was actually used for consumption and to repay a previous debt).

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variety of forms of security. A quarter of the loans borrowed from the informal sector as a whole were not secured by any kind of collateral, while crop (14%), labour (12%), bond and jewels (20%) were the more generally accepted security for the other 75%. It is quite striking that **although informal credit is biased towards the landed classes, land itself is used as collateral in less than 1 per cent of cases. Its role as a collateral is confined to the formal sector.** Although types of collateral are not exclusively associated with types of lending institutions, there is a strong tendency towards segmentation. Pawnbrokers and moneylenders mostly accept gold and silver, bonds and other precious metals (jewels), and they rarely offer money without collateral. Traders secure more than 50% of their loans not only on the future crop, but also on pledges of labour, bonds and on personal reputation. Silk merchants secure their loans with labour. About 50% of loans from friends and relatives were unsecured and another 10% were based on personal assurance. Kin and friends, therefore, rely more on

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reputation.

Collateral is patterned by caste, gender and class. Female headed, illiterate and Scheduled Caste households use bonds, jewels and personal reputation the most, while literate, male headed households and those of other castes usually offer bonds, future crops and land as collateral. As Table 12 shows, land and crops are the kind of collateral most commonly used by elites. Landless households and marginal farmers, instead, have to rely on personal assurance, bonds, jewels and future labour agreements. It is noteworthy, however, that the percentage of loans secured by collateral is lower for the poorest households. This partly reflects the fact that poor households get fewer formal loans (which need to be secured by some form of collateral, although it often has to be land or gold) and partly may be explained by the fact that poor households have less collateral to offer, and of lower quality.

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Table 12: Financial sources and collateral

		Financial Sources							
		Formal Institution s					Informal Institution s		
		Co- Operatives	Commerci al Banks	Land Developmen t	IRDP	Total Formal	Moneylend ers & Pawnbroke rs	Traders	Silk Merchant Weavers & Shoopkeep ers
T y p e									

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of C ol la te ra l									
T ot al n u m b er of		16	13	3	2	34	42	36	16

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lo a n s									
L o a n s wi th o ut c ol la					54,1%	2,6%	7,9%	13,9%	13,8%

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wi		100,0%	100,0%	100,0%	45,9%	97,4%	92,1%	86,1%	86,2%
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	obs	16	13	3	1	33	38	31	14
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	Gold & Silver	15,8%	18,2%			14,6%	15,3%		
	Land	48,0%	53,0%	61,8%		48,9%	2,3%		
	Crop	15,3%	6,9%			9,8%	3,1%	55,2%	8,8%
	Bond	3,2%				1,5%	20,1%	11,4%	6,6%
	Labour	7,3%				3,4%	1,7%	10,9%	61,7%
	Personal	5,6%		38,2%	45,9%	8,2%	2,3%	8,6%	
	Brass vessels								
	Bond & jewels	4,8%	18,2%			9,5%	47,2%		
	Loom								9,1%

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	Other		3,7%			1,5%			
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Tables 13 and 14 break down collateral in terms of the social status and class of borrowers. More loans are completely unsecured by lenders to FHH, IH and SCH than to male, literate caste borrowers. Bonds and reputation are prominent kinds of security for loans among the disadvantaged. For informal loans, land drops out completely as collateral for socially and economically **advantaged** households but remains important for a minority of FHH where gold and land secure them loans, (which accentuates the difference between this group and SC, landless or poor labouring households). Distinguishing between poor landed and equally poor landless households (Table 23), we see that only a tiny fraction of the collaterals of those small and marginal peasants with land is made up of land. **The possession of land broadens their access entitlements, but land is protected from exposure as a front-line collateral. Since the landed poor do not use land as a collateral, the hypothesis which we started with, that the relationship between the value of land as collateral and the directly**

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productive value of land alters through the land distribution, is not relevant .

Instead we find that land in these villages is a prior screen of eligibility and is considered by lenders as a security of last resort. Other collaterals can be used because the borrower has land. Crop and labour are distributed as securities in opposite ways. Crops rise and labour pledges fall with increasing land holding size. Yet labour pledges **are** used as security even among the elite and reveal again the intense desirability to lenders of being able to interlink credit, product and labour ‘markets’ or arrangements.

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Table 13: Social Characteristics and Collateral

		Gender		Caste		Education	
Type of Collateral		Female Headed	Male Headed	Scheduled Caste	Other Caste	Literate	Illiterate
Total num ber of loans							
Loan		28,1%	21,1%	31,7%	15,4%	25,8%	19,4%

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s with out colla teral							
	<i>obs</i>						
Loan s with colla teral		71,9%	78,9%	68,3%	84,6%	74,2%	80,6%
	<i>obs</i>						
of whic h:							
	Gold & Silver	9,93%	5,76%	1,45%	8,71%	1,68%	8,04%

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	Land	10,19%	8,25%	2,26%	12,01%	4,48%	10,21%
	Crop		14,12%	6,63%	17,38%	1,36%	19,07%
	Bond	26,21%	16,76%	15,01%	18,63%	19,27%	16,32%
	Labour	8,03%	10,70%	9,47%	11,20%	15,80%	8,05%
	Personal	17,49%	7,10%	14,81%	3,38%	13,55%	4,86%
	Brass vessels		1,11%	0,94%	1,12%		1,55%
	Bond & jewels		14,08%	17,14%	11,02%	18,09%	11,03%
	Loom		0,79%		1,20%		1,11%
	Other		0,25%	0,62%			0,35%

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Table 14: Economic characteristics and collateral

		Economic Character istics								
		Landhold ing					Cluster			
Type of Col late ral		Landless	Marginal	Small	Medium	Large	Poor NL	Poor L	Middle NL	Middle
Total num ber of							56	46	16	43

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loan s										
Loan s with out colla teral		28,1%	28,0%	13,3%	11,8%	17,5%	37,4%	16,4%	14,5%	15,0%
	<i>obs</i>						22	9	3	6
Loan s with colla teral		71,9%	72,0%	86,7%	88,2%	82,5%	62,7%	83,6%	85,5%	85,0%
	<i>obs</i>						34	37	13	37
of whic h:										

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	Gold & Silver	3,54%	5,26%	2,89%	13,71%	13,26%	5,75%	3,05%		12,07%
	Land		4,42%	4,88%	35,48%	18,57%	1,95%	6,99%		17,00%
	Crop	4,81%	12,16%	26,89%	5,79%	18,85%	1,90%	12,48%	8,64%	19,69%
	Bond	18,80%	16,46%	14,05%	21,93%	16,55%	20,94%	12,89%	8,64%	17,24%
	Labour	10,10%	15,23%	14,26%		5,31%	9,09%	15,94%	16,97%	8,83%
	Personal	18,50%	4,40%	2,89%		2,30%	13,43%	4,71%	17,28%	2,80%
	Brass vessels		4,65%					1,67%		2,80%
	Bond & jewels	14,64%	8,10%	19,85%	11,32%	7,62%	9,60%	24,47%	29,78%	4,57%
	Loom	1,48%	1,29%					0,58%	0,92%	
	Other			0,97%						

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* **Collateral and interest by source**

Lenders accept a range of forms of security and appear to discriminate between collaterals in their interest charges (Table 15) . However, they rarely behave consistently across the board. **Bonds** (at 36-40% from most sources) and **crops** (in a narrow band of interest around 20%) are the exceptions and **by the criterion of interest behave most like an integrated market**. For the other kinds of collaterals there are mixes of high and low interest, or none at all, suggesting either non-commercial exchanges or loans linked to returns on other markets, which co-exist with commercial contracts. Interest at 60% on the security of land and at 120% on personal security suggest that moneylenders exploit a degree of monopoly control where social factors permit no alternatives to borrowers. Madhura Swaminathan's hypothesis that interest reflects the marketability of collateral is confirmed here. Of the four common collaterals, crops at 19% are by far the most easily commercialised. Gold (29%) is more

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marketable than jewels (35%). Brass vessels and bonds/promissory notes fetch 38-60% , being hard to resell and harder to redeem in court. Unmarketable personal assurance tends to require 40-120%. Of all the types of lender, specialised moneylenders most consistently discriminate interest according to the marketability of collateral (see Agarwal, 1997).

Table 15 Annualised Interest by Source and Collateral

INTE REST RAT ES		Informal Institutions					
		Moneylenders & Pawnborkers	Traders	Silk Merchant Weavers & Shoopkeepers	Friends & Relatives	Other Informal	Total Informal
Type							

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of Collateral							
Total number of loans		40	32	15	29	39	155
Loans without collateral			2,5%		6,6%	37,0%	18,5%
	<i>obs</i>	<i>4</i>	<i>5</i>	<i>2</i>	<i>17</i>	<i>14</i>	<i>42</i>
Loans with collateral		37,3%	17,5%	7,7%	22,0%	31,6%	26,9%

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ral							
	<i>obs</i>	<i>36</i>	<i>27</i>	<i>13</i>	<i>12</i>	<i>25</i>	<i>113</i>
of which :							
	Gold & Silver	29,4%					29,4%
	Land						
	Crop		18,8%				16,9%
	Bond	40,0%			38,6%	36,2%	36,5%
	Labour			0,0%			1,9%
	Personal					40,7%	35,4%
	Brass vessels						
	Bond & jewels	34,9%					35,0%
	Loom						

Note: Filled cells denote estimates with less than five observations

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n = number, I = interest, ml = moneylenders and pawnbrokers, silkm and m weavers = silk merchants and master weavers, fr and rel = friends and relatives, slver = silver, jwl = jewel.

3. CONCLUSIONS

Even though most money-borrowers confine themselves to one or two sources of loans, there is a vast array of credit institutions servicing these villages. They range from state-managed credit and banking schemes (IRDP; Land Development Banks and Co-operative Credit Banks) through state regulated private commercial and nationalised banks, to informal moneylending dynasties, pawnbrokers, grain traders, silk merchants and master weavers, shopkeepers, elite farmers, chit fund organisers (from farmer's wives to school teachers and shop keepers) and itinerant moneylenders.

Formal - state regulated and often state owned - credit has been a major

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component in India's 'heavy agriculturalisation', the initial phases of which had been dominated by informal credit. Informal credit in Northern Tamil Nadu tended to preserve smallholder agriculture and to slow - though not to halt - the pace of the process of landlessness. Even so, the proportion of the rural population which is landless has increased - in the three villages - by one third between 1983-4 to 1993-4.¹⁹

Despite two decades of targeted credit, with rates of achievements in priority sector lending in Tamil Nadu of 2.5 times the national average, by 1993-4 there

¹⁹19. From a weighted average for the three villages of 25% in 1973 to 30 % in 1983 to 40 % in 1993-4 - using our field survey data plus data in Hazell and Ramasamy (1991) p. 68, p. 111.

were signs of a trend of reversion to forms of finance reminiscent of those of the seventies, as a result of which formal credit does the exact opposite of its stated purpose - to favour marginal groups and supplement private credit (Kohli, 1999). In practice, the two systems have developed as complements. The distribution of debt is more unequal than that of land and the distribution of formal credit is more much unequal than that of informal credit.²⁰ Despite the problems of extrapolation from the 11 village survey in 1983-4 to the three village one in 1993-4, formal state regulated credit directed to agriculture seems to have shrunk in relative terms, the co-operatives shrinking at the expenses of private

²⁰20 . Half all formal credit is taken by the 7% of borrowers with more than 5 acres of land while the landless and those with micro-holdings - 58 % of borrowers - gain access to less than 10%.

commercial banks. Formal credit is the preserve of traders and of the rural elites from whom, according to the village credit profiles, we know it is lent onwards. It thus fuels informal financial arrangements. While the rural elite is not wealthy by local urban standards, these credit relations are differentiating.

The informal sector dominates rural credit, both in numbers of loans and volumes of money. Unlike the conclusion for 1983 and unlike findings elsewhere in India, ²¹ merchants' credit remains important - on a par with state- managed credit, reflecting the value to traders of interlinked contracts. Traders' credit in the *non-farm* economy now supplements that in agriculture proper. Our results are consistent with those of Reddy (1992) who finds these interlocked contracts to be prevalent in 'developed' and diversified rural regions of India and of

²¹21 . J. Harriss, 1991; Sarap, 1990

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Janakarajan (1993) who found them in adjacent Chinglepet District. Loans repaid in kind do not necessarily signify backwardness. The fact of a contract does not indicate the role it plays. Interlocked contracts do, however, deprive the borrower of choice on two or three markets and in so doing, they shape the distribution of the gains to production and trade, biasing it towards trade.

Informal money markets consist of sets of highly personalised arrangements in which specific kinds of lender are accessed by specific kinds of borrower for specific purposes with a great range of terms and conditions. These markets are fragmented. Interest rate differences are most unlikely to be removed if risk could be factored in, though our data did not actually enable us to do this. Social relations and social status fragment these markets. While all classes can gain access to moneylenders and pawnbrokers, friends and relatives are key sources for the poorest borrowers while paddy and silk traders dominate loans to the rural

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elite. Being scheduled caste and female is a formidable barrier to formal sector credit. Whatever they own, women who head households are effectively without acceptable collateral. They are constrained to borrow from friends and relatives.

²² Many of these loans are without interest and based on a non-market solidary

²²22. We do not know whether loans from friends and relatives forms part of the tribute from wife givers to wife receivers (DrPze et al, 1998). Certainly these loans flow inside the villages which was not the case in Palanpur; but the South Indian kinship system (being jettisoned for North Indian elements by the dominant agrarian castes while low caste people are increasingly 'Dravidianising' themselves (Harriss-White, 1999) features cross cousin marriages, which are frequently *within* villages.

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logic of reciprocity associated with poor people. This category may include women-only chit funds. The village profiles revealed that both female heads of households and other women use a specific system of circulation of money, organised by and for women, but masked in the survey under the code ‘friends and relatives’.

Illiteracy is almost as forbidding a barrier to access to credit as is being female. Scheduled caste borrowers are also excluded from formal credit and, being for the most part landless, from traders’ credit as well. Their loans are confined to scheduled caste chit funds (of which there is a massive proliferation), moneylenders and pawnbrokers. From the latter sources, they can borrow only on a small scale and at high interest and their loans are strikingly for ‘consumption’ purposes. Consumption is the production of labour. It is of no concern to state regulated credit, despite the fact that the difference in informal

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interest for production and consumption loans is not significant, which may indicate that moneylenders reckon that consumption loans are not significantly more risky.²³ None of the factors which structure *exclusion* from credit can be other than adversely affected by the social sector cuts which form part of the paradigm of liberalisation.

The least fragmented elements of credit relations, and ones in which ‘markets’ are beginning to be integrated, are those using bonds and crops as collateral - right across the informal sector - and the arrangements involving grain traders, silk merchants and professional moneylenders where the borrowers tend to be the agrarian and rural elites

²³23 . Though these are other explanations for interest rate variation than risk, as we see below.

Interest rates are subject to competing explanations. The *loan cost* argument from which interest is predicted to be highest among the credit-starved poor cannot account for the high frequency of loans to poor people at no interest. The interest rates in these villages do, however, reflect *transactions costs* in so far as transactions costs are found (with exceptions) to reflect the marketability of collateral.²⁴ Though lack of information on overdues and default stymied our analysis of risk, we do know that consumption loans are not charged higher interest than production loans once the source is factored out. Either risk is not a factor in interest, or, as we suspect, consumption loans are not riskier than

²⁴24 . Otherwise the transactions costs of getting loans are much lower than those for social security benefit (see chapter 3-6).

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production loans since they ‘produce’ labour through which loans are repaid. Interest varies significantly with the *precise institutional source* from which loans are obtained - irrespective of the collateral offered and the social status of the borrower. *Pace DrPze and colleagues (1998)*, we have no evidence that formal sector credit has by itself made informal credit more usurious. The fragmentation of informal credit with particular ranges of interest is of long standing.

Both land and livestock (but no other form of collateral) play contradictory roles in demand for credit. First as collateral, they secure income-increasing loans. Second, as direct generators of income they reduce demand for loans. When these assets increase in value then their role as income earners replaces that of collateral. Indeed we found that for informal loans, land drops out as a collateral as assets increase. Informal lenders accept labour and product pledges on a far

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wider scale than in the formal sector and from all classes of agrarian society. In both formal and informal sectors, significant amounts are lent unsecured by any collateral. The incidence of unsecured loans is higher for poorer households and landless borrowers, the reverse of what was expected. While these groups also pay higher interest on loans, lack of collateral was of no statistical significance in explaining these rates.

3.1 : Deregulation

Credit relations are changing as the non-farm economy grows, creating demand for credit of a type (consumption and production) and in sectors (low caste landless labour, women, agrarian weavers) ignored by the formal sector. If, as envisaged in the millennial budgets, credit is further deregulated (taking the form of 'detargeting', removing interest subsidies but without changing conventions on collateral), it is abundantly clear that the rural elites will continue

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to be the major beneficiaries. And the much wealthier urban eminences grises in silk manufacturing and paddy-rice trading (who routinely borrow from private commercial banks and who lend onwards in ways which personalise lending arrangements and which contractually lock two or more markets together) will benefit indirectly from the impact on rural elites. Though formal lending is retrogressive, further deregulation will not have redistributive outcomes. The state intervened in the first place for a set of reasons which are still valid. The state has proved unable to deliver equitable access, **but deregulated banking will further exacerbate the lack of equity in access.** The village of Veerasambanur shows that **co-operative credit *can* reach remote and poor villages.** Of the three villages studied Veerasambanur had the most extensive and inclusive credit relations and the most active formal sector. Directed credit policy has a new opportunity to respond to the rapidly changing structures of rural credit. Through state credit, dependent out-working might be replaced by a

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non-agricultural form of petty production independent of mercantile control, an objective which the better assetted weavers are themselves trying to achieve.

3. 2: The Collateral Question

The collateral of poor people - those with no land at all or micro-properties of 0.1 acres and below - needs not only increasing but also improvement in quality. Land titling for male and female tenants and credit of the purchase of land are all consistent with the results of our research. **Loans for land** are the most practically and politically feasible.

But the collateral question is not quite so simple. In the formal sector land is the most important single form of collateral. Land confers access rights to credit. Small scale landholding enables preferential access to the IRDP, to a wide range of formal and informal loans and thus to larger loans at lower interest than

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otherwise. In households with similar incomes, a micro-landholding of 0.1 to 1 acre enables a borrower to double the size of loan taken and to invest in production rather than consumption. These benefits are enough to justify loans for land. However, holdings below 5 acres in size do not confer working rights to *formal* credit. Only the agrarian elites have secure entitlements the state regulated finance.

In the informal sector, the role of land is subtle. Land is rarely used as collateral for informal loans. Landownership is a screening device. Other collaterals are then used for loans. Land is then a second-order collateral of last resort activated only in cases of long default, when the first order collateral has been relinquished by the borrower.

Rural credit policy has long been Janus faced. State regulated credit complements

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informal loans. Acting to preserve small scale production (but not reaching it directly), the state subsidises the agrarian elite perhaps because they are unable to survive using capital biased technology without subsidised credit, perhaps because production with wage workers is more costly per unit of output than that with family labour, but certainly as a differentiating service to capital and one which would be **more** differentiating if deregulated.

Yet the state has also preserved petty production not only by tolerating onward informal lending by formal borrowers but also by its own assets-creating schemes (such as the IRDP) and by the successful penetration of remote villages by co-operative credit. At the very least, potential buyers of land ought not to be prevented from making their choice. *De facto* the lack of choice prevents Scheduled Caste people from acquiring land. That the balance of these contrary policies currently favours the propertied elites is very clear from the expansion of

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the rural market for labour, most of which is Scheduled Caste.

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ENDNOTES

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