

CHAPTER I

INTRODUCTION

Credit is usually considered to be an entry point to development. For the poor credit provides means for survival. Prof. Yunus of Bangladesh very aptly describes access to credit as a basic human right (qtd.in Gibbons and Kasim 1990: pp 59-60).

At the macro level, the developing countries have formulated and implemented plans and programmes for rapidly growing rural credit systems. In the last four decades, a significant and growing proportion of savings and the scarce resources of the state have been deployed as rural credit.

Traditionally, credit analysis has been confined to operations and viability of the rural banking system and programmes. However, at the present juncture, an indepth probe into the end-use of credit and its impact on the income and welfare of the small households assumes critical importance. The development planners and bankers are eager to know the complexities of the credit process, the impact of credit on the production systems/business units and on the socio-economic upliftment of the borrowers. Hence, in the area of credit analysis, the focus of research needs to shift from institutional analysis to household level impact studies.

Rationale of the Study

The present institutional structure for rural credit in India consists of a multi-agency system functioning at various levels. The primary credit delivery system comprises of scheduled commercial banks, regional rural banks (RRBs) and the co-operative credit sector, comprising of primary agricultural credit societies (PACs), large-sized adivasi multi-purpose societies (LAMPS), farmer's service societies (FSS) and the rural and agricultural development banks.

In the year 1992-93, the institutional structure for rural credit consisted of 14689 rural branches of nationalised commercial banks, 13456 branches of RRBs, 19 state/central land development banks and 83,000 primary agricultural credit societies (including LAMPS AND FSS).

Table 1.1 shows the agencywise distribution of direct institutional finance for agriculture and allied activities.

TABLE 1.1

Direct Institutional Finance For Agriculture and Allied Activities
(Rs. Crore)

Source Of Finance	Loans Oustanding As on 30.6.1993	Percent To Total
I. Co-operatives (including (a) short-term loans by PACS including LAMPS and FSS and (b) medium and long-term loans by PACS/CLDBs.)	13,243.9**	39.34
II. Scheduled Commercial Banks* (excluding RRBs)	1,8287.87	54.32
III. Regional Rural Banks*	2,132.2	6.33
TOTAL DIRECT FINANCE (I to III)	33,663.9	100.00

Note :

** : Provisional

* : includes short-term
and long-term loans

Source: Report On Currency And Finance
1993-94. (Volume I)

As shown in table 1.1 the total outstanding direct loans for agriculture and allied activities by the institutional agencies amounted to Rs.33,633.9 crore as at the end of June 1993, where in, shares of co-operatives, commercial banks and RRBs was 39.34 percent, 54.32 percent and 6.33 percent, respectively.

The rural credit market is full of problems at present. In spite of the vast network of credit outlets and a number of developmental programmes operating in the rural areas,

poverty in the rural sector remains an impediment to the balanced growth of the country. Several lending institutions are non-viable or defunct due to persistently rising level of non-performing assets.

The massive flow of state subsidies to the rural sector for providing cheap credit amounts to waste of scarce national resources. The above factors make it pertinent to measure and analyse the impact of credit on those for whom the system functions.

Importance of Household as a Unit of Analysis

Large number of plans and programmes for economic development, and especially the structured adjustment programmes (SAPs) implemented in the eighties, aim at increasing the output, irrespective of the inequality in the income distribution patterns and the adverse impact on the non-market sectors where women are the main players. SAPs are mainly concerned with reshaping the developing economies into market economies. The performance of the economies are evaluated by using macro-economic indicators including growth rate of the gross domestic product, price indices, balance of trade and payment surpluses and fiscal deficits. The impact of these reforms at the household level is totally ignored. The SAPs were formulated on the basis of popular economic paradigms which have no human face. The ultimate goal of all economic development and growth is promoting the welfare of the people. The impact of SAPs has to be measured

at the household level, especially the rural ones, to understand the changing relationships and roles of men and women, with respect to production and consumption.

Of late, household as a unit of study has assumed great importance. This is chiefly because the impact of any developmental scheme/programme can be best captured at the household level. For it is the promotion of welfare of the household which forms the basis of all such programmes/schemes. Further, household is a typical unit which is engaged in both production and consumption of goods and services.

Since the inception of the Lead Bank Scheme in 1969 and the adoption of the Service Area Approach in 1988, it is clearly visible that there is a policy shift from central planning to micro planning. It is much more practical and effective but indeed difficult to study the credit deployment process and the problems at the micro or village and even more difficult at the household level. The lender-borrower relationships are very complex and require an indepth analysis at the grass-root level for proper understanding and revealing clues for guiding future policy. This study makes a humble attempt in this direction.

Conceptual Framework

The operations of the rural financial markets can be examined from four dimensions. The first is the performance of the financial intermediaries. The second is the impact of credit

on borrowers including their performance evaluation. The third is the growth of the financial markets in a time frame and the last is the impact of the financial market's performance on the process of rural development.

According to J.D. Von Pischke (1991), Performance evaluation of the borrowers is justified in three cases. First, credit use creates value. It increases or decreases the size of the economy and influences resource allocation. Further, the saving, investment, and consumption behaviour of firms and households constitute important development variables. Second, in case of targetted credit schemes, project objectives are stated in terms of borrowers or selection of activities and performance. Hence, the achievements and failure of the scheme are identified and variations from targets measured so that the project design can be improved. Third, when financial institutions take up market research such as collecting information from budgets and building lending models as for credit decision making.

Review of borrowers' performance serves five major purposes. Firstly, it helps in ascertaining that credit is used for the sanctioned purpose/activity. The proportion of misutilisation of credit can be estimated. Secondly, to measure the returns from credit use especially with reference to repayment of loans. Thirdly, to identify and contrast the characteristics of good loans and of bad loans and good borrowers and defaulters. Fourthly, the gender composition of borrowers will help in understanding and estimating the performance of intermediaries in

mainstreaming women and backward classes in the process of development. Lastly, it reveals the quality of the lenders risk-taking and credit decision-making ability and provides guidelines for improvisation in lending policy and practices and project design. The analytical focus of this study is on measuring the impact of credit on borrowers. The economic impact of credit on borrowers is assessed by examining the changes created by the loan-use on the employment, output and income of the borrowers.

Major Controversies and Issues

The rural credit market in India and in most of the developing countries has a history of more than four decades. The international literature is full of controversies and our literature review brings to the fore some of the major ones which are discussed below.

The first major controversy is about the subsidised versus market rate of interest on credit for the poor. The market is serving a very large population and yet many are still outside the reach of the formal lending markets in the "frontier". The frontier is defined as the limit of the activities of formal financial institutions by J.D Von.Pischke. Population can be divided into two groups. The rich with pledgeable assets: their credit needs are easily catered to by the lending institutions. But a much larger number are poor, who are not considered credit-worthy and so the banks are not willing to finance them.

The governments in their role of development planners have subsidised plans and programmes providing cheap credit on the basis of bankable productive schemes implemented through the lending institutions. Unfortunately, such credit has not achieved much in terms of poverty alleviation. On the other hand it resulted in several lending institutions becoming non-viable and defunct. Hence, the search is on for a better alternative. For the last four decades, the state has used lending institutions as channels for promoting agriculture and rural development. The subsidised credit policy is based on the assumption that poor cannot afford to pay the market rate of interest which is higher compared to the low rate of return on the end use of credit. Experience shows that the gigantic quantum of cheap credit leads to wasteful use of scarce resources as there was no incentive for improving productivity and production, which kept the income level of borrowers perpetually low. The modern school of thought has challenged the hypothesis of cheap credit and propounds the idea that even poor can afford credit at market rates of interest: what they require is sustainable sources of credit. Dale Adams and J.D. Von Pishche are the main canvassers of this theme. The famous Grameen Bank experiment in Bangladesh is quoted in support of this theme.

The second controversy is regarding the role of informal credit market. The traditional school of thought wants the informal lenders for providing optimum credit to support development. to be tolerated at best as necessary evil.

Their limitations such as very high interest rates (ranging from 30 to 70 per cent per annum), fraudulent accounting practices and taking undue advantage in other functional relationships of supply and marketing etc are too well known to be elaborated. On the other hand, Dale Adams, Von Pische et al of the modern school of thought stress that informal lenders play a very vital role in providing credit and they need to be developed, disciplined and made to function in a complimentary fashion with the formal lenders for providing optimum credit to support development. This school believes that formal credit sector alone cannot provide all the credit needed for optimum development. Further, the national goal of poverty alleviation could not be achieved at the expected rate.

What is needed is data collection and analysis of the functional aspects of the informal credit market for providing evidence of its useful role. The incentives and obstacles to credit flows need to be identified for developing informal credit system as complementary force to the formal credit system.

The third controversy is regarding the manner in which women can be brought under the fold of rural credit. There are studies all over the world, which highlight that the traditional rural banking systems have bypassed women. The factors responsible for this are lined up on both the supply and demand side of credit. On the supply side the lending agencies are blamed of having policies and practices which are discriminative or at best unconcerned about the fair sex's credit needs.

Women are viewed as 'higher risks' by credit managers, whereas, mounting evidence from all over the world proves that they are 'better risks' than men. Not only do they repay loans on time but they also use loans more efficiently. The lending policies with emphasis on securities, guarantees from male family member, heavy paper work and several visits to bank for negotiating and the ultimate disbursement of loans, keep women away. On the demand side the major problem is that women's productive work is generally in the non-market sectors of the economy, which lie outside the orbit of the lending agencies. Illiteracy, social customs, ethnic customs, lack of productive skills, diffidence of making business contacts are some of the often quoted factors which force women to depend on informal sources of credit and avoid the banking system.

In 1975, the U.N. conference on Women at Mexico-city for the first time highlighted the need for mainstreaming women in economic development. Since then, governments all over the world have been concerned with the introduction of gender perspective in their development processes. Attempts are made to provide credit through the mainstream banking systems through special schemes for women. However, lending institutions only for women are not found to be viable alternatives.

What will work is the women-friendly policies and practices of the lending agencies and updating of literacy and skills of women matching the bankable schemes in which women have efficiency edge over men. It is important to enquire into the

women's participation in credit markets and the impact of credit on them. Such a study can highlight the factors which help women in borrowing for productive purposes and the obstacles which keep them away. Further if there is a positive socio-economic impact of credit on women, then studies capturing it can be publicised for enhancing women's access to credit. Such findings can help in improvising the policies and decisions of state and lenders for improving women's access to credit.

In view of the above, at this juncture, it is pertinent to collect more evidence and information for exploring and understanding the complexities of credit markets, so that the policy changes are backed by solid evidence rather than solitary success stories. This is precisely the broad objective of this study.

Objectives:

This is an analytical study which aims at assessing the economic impact of institutional credit on the rural households by analysing the effect of credit on the generation of employment, production and income of the sample borrowers in the Vadodara district, of the state of Gujarat.

The specific objectives of the study are as follows:

1. To identify the important socio-economic characteristics of the borrowers, which may have influence on impact of credit on them;

2. To find out the types of economic activities financed, from credit;
3. To identify and analyse the distribution pattern of loans, with respect to loan-size, activity gender and caste.
4. To assess the economic impact of institutional credit on the employment and production levels of the borrowers with special reference to activity, gender, headship of the household, and caste.
5. To assess the economic impact of institutional credit on the income of the borrowers with special reference to activity, gender, headship of the household and caste.
6. To identify the factors which have favourable or negative influence on the impact of credit on the borrowers.

CHAPTER OUTLINE

The desertation is divided in to nine chapters. The first chapter deals with the rationale, theoretical background and conceptual framework of the study followed by identification of major controversies and issues in the area of study. Lastly, it presents the objectives of the study. The second chapter reviews the existing literature on impact and evaluation studies. The third chapter presents the methodology and data sources used for the study. The fourth chapter presents the socio-economic profile of the sample district and villages. The fifth chapter dicusses the characteristics of the sample borrowers which may

have influence on the impact of credit of on the borrower. The sixth chapter identifies and analysis the loan size and distribution of patterns. The seventh chapter analyses the impact of credit on the borrowers' employment and production levels. The eighth chapter analyses the impact of credit on the borrowers' income. Both seventh and eighth chapters analyse the impact of credit with special reference to activities financed, gender, household headship and caste of the borrower. The ninth chapter summarises the main findings of the study and identifies the factors influencing the impact of credit.

- I Introduction, Rationale, Objectives, Chapter outline and Summary of findings
- II Literature Review
- III Methodology and Data Sources:
Primary survey; sample design, questionnaire, data sources and description statistical techniques.
- IV Socio-Economic characteristics of Baroda. District Profile and of sample villages.
- V Sample borrower and loan profile
 - (1) Demographic and economic characteristics of the borrowers; Age, caste and education, marital status, housing and economic activities pursued.
 - (2) Classification of loans: typewise, activitywise, size wise, genderwise, headshipwise, formal/informal/investment/credit ratio.
- VI Impact of Credit On: Employment, Production and Income.
- VII Impact of Credit On Consumption and Private Debt Repayment.
- VIII Conclusions and Recommendations.