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Informal credit in West Bengal: Why is it continuing and what is the solution?

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ABSTRACT

Credit is a very important factor for the capital poor farmer in agriculture. Before bank nationalization informal agencies were the main sources of credit in the agrarian economy of India as well as West Bengal as part of the country. But, after bank nationalization informal sources, up to a considerable extent, has lost its importance. Institutional agencies comprising co-operative banks, commercial banks and regional rural banks have come to the focal point as sources of credit in general and rural credit in particular. But, in spite of that, informal agencies like moneylenders, traders etc. have been operationally active and functional with a considerable space in the rural credit market in the country. Now, in the paper attempt has been made to find out possible factors responsible for informal agencies continuing and strengthening its operational network.

To do this, both secondary and primary sources of information and data have been used. The issue of financial inclusion, especially of the rural poor has been discussed. In the concluding part, a few suggestions have been made.

KEY WORDS: Informal credit, financial inclusion, Nationalization, Flexibility, Credit

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INTRODUCTION

Agricultural credit needs of the rural people on the basis of purpose can be compartmentalized into three categories- (i) productive, (ii) consumption, and (iii) unproductive. Farmers need loans for purchasing inputs like seeds, fertilizers, manures, pesticides, living stock and agricultural implements like tractors, harvestcombines etc.Along with other inputs, credit is required for establishing sustainable and profitable farming, Bhalla[1] expressed. Repayment of these loans is generally not difficult. The production impact of the loans generates value added to the total production of the debtor. The increased production helps him to repay the loan. People, particularly landless laborers and marginal farmers often require loans for consumption purposes. In between the period of marketing of agricultural produce and harvesting of the next crop, they do not have sufficient income to sustain themselves through this period. Therefore; they are compelled to take loans for consumption purposes. Formal credit agencies do not provide loans for consumption purposes. As a result, poor or financially weaker people surrender to the moneylenders for their hand to mouth. Lastly, loans for other unproductive purposes like marriages, ceremonies, birth or death of a family member, religious rituals and other festivals, people usually go to the informal moneylenders. As these activities do not contribute to the production, it becomes very difficult to repay these loans.

A review of available literature suggests that moneylenders continue to provide financial intermediation in areas that are underserved by formal institutions. Following RBI Report[2] it can be said that very small scale is the critical determining factor, asthey (moneylenders) are able to provide very tiny sums of loans .Apart from that, moneylenders give loan for productive, consumption and other purposes, which formal agencies do not do. “The existence of personalized relation between the borrowers and the lenders of the fact that each lender lends only to those over whom he has some control.” The inherent flexibility and the speed with which the transaction is completed havefavoured informal agencies to continue their operations. The informal sector saves as lender of last resort to those who are unable to obtain finance in the formal sector because the transaction costs of lending to this group are prohibiting, as the loans they demand are so small.

OBJECTIVES

This paper tries to analyze that, in spite of the fact that the informal sector loans are exploitative and the interest rates charged are exorbitantwhat are the reasons for which the sector continues to persist and somewhere it enhances its operations. Secondly, to find out the solution such that the poor and weaker sections of people come out of the clutches of the informal credit agencies and comes under the coverage of financial inclusion.

METHODOLOGY:

To do this, mainly secondary sources of information and data have been used. Different Government reports, RBI publications, NABARD reports and different articles published in different journals have been used. Besides, a household-level survey data from two villages of two different Blocks of Birbhum district, West Bengal, have been used and interpreted as a complementary part of the secondary data and information to analyze the issue.This could be a miniscule representative scenario of the ground reality of the credit network in rural areas of West Bengal.

VOLUME AND TREND OF INFORMAL CREDIT VIS-À-VIS FORMAL CREDIT

About 71% of rural credit was supplied by informal agencies prior to bank nationalization in India. In 1969, when bank nationalization program me was undertaken a multi-agency approach has been introduced. Banks were directed to provide credit to underprivileged sections of the rural population, Chavan[3]opined. After this, percentage-wise share of loan advanced between non-institutional and institutional sector has gone against the former one. The relatively greater degree of institutionalization of the credit might have een partially due to anti-poverty programs like Integrated Rural Development Program me or IRDP, Bhattacharyya[4]argued. That is, informal sector lost its previous importance, though still a considerable portion of rural credit, especially to the poorer section of the rural population has been supplied by this sector. Of the non-institutional agencies moneylenders have played the predominant role because poor farmers were compelled to borrow from them as they were at the doorstep of the borrowers, and, ready to lend anytime. This almost total dependence of the borrowers enabled the informal agencies to dictate the terms and conditions of the loan, and, exploit the poor people of the villages. The interest rates of the informal loans are very high.“Typically, a rural moneylender serves a fixed clientele whose members he lends on a repetitive basis; he is extremely reluctant to lend outside the circle,” Roy[5]stated.

After the financial sector reforms of early 1990s, the policy of withdrawal of the financial sector especially priority sector lending has led informal sector to flourish again. According to Chandrasekhar and Ghosh[6], liberalization involved ending the dichotomy between banking and development finance.Money lenders expanded their operational activities to a great extent. Side by side, microfinance sector started to fill-up the gap created due to the withdrawal of the institutional sector.

The All India Debt and Investment Survey as on 30th June, 2002 (NSS Ninth Round released in December, 2005, cited in RBI report, 2007) showed that the share of moneylenders in the total dues of rural households had increased from 17.5 percent in 1991 to 29.6 percent in 2002.RBI presumed that high indebtedness to the moneylenders could be an important reason for the distress among the farmers. The enquiry report of the Technical Group set up by the RBI,stated that in many ways the indigenous bankers formed an indispensible link between the organized banking system and the class of small borrowers who generally may not get funds at the right time and in the right quantum from the organized banking system.

An analysis of the source-wise distribution of outstanding loans taken by farmer households in different states in India is given below in Table1.

Table 1: Per 1000 rupees distribution of outstanding loan taken by farmer households in different States

	Sources of Loan								
	Govt.	Co-op. society	Bank	Agri./ profess-ional money lender	Trader	Relatives & friends	Doctor, lawyer etc.	Others	All
Andhra Pr.	10	104	200	534	48	53	9	41	1000
Arunachal Pradesh	61	0	208	0	159	507	0	65	1000
Assam	70	27	278	155	120	247	5	99	1000
Bihar	22	25	370	328	11	128	12	106	1000
Chhattisgarh	13	206	505	130	42	63	7	35	1000
Gujarat	5	418	272	65	44	177	9	10	1000
Haryana	11	239	426	241	31	34	15	4	1000
Himachal Pr.	61	116	476	72	55	170	1	49	1000
Jammu & Kashmir	131	2	543	11	155	155	0	2	1000
Jharkhand	39	45	557	190	17	136	4	12	1000
Karnataka	19	169	501	200	19	68	4	21	1000
Kerala	49	283	491	74	17	66	10	9	1000
Madhya Pr.	19	169	381	226	90	101	5	8	1000
Maharashtra	12	485	341	68	8	59	3	24	1000
Manipur	15	0	167	329	40	401	0	49	1000
Meghalaya	60	0	0	128	3	809	0	0	1000
Mizoram	243	31	499	0	33	193	0	0	1000
Nagaland	75	77	536	3	153	155	0	0	1000
Orissa	130	181	437	148	8	84	1	10	1000
Punjab	19	176	284	363	82	63	6	7	1000
Rajasthan	13	59	270	365	192	69	18	14	1000
Sikkim	348	0	230	73	221	67	0	61	1000
Tamil Nadu	20	233	281	397	4	52	1	11	1000
Tripura	164	28	605	20	39	119	0	25	1000
Uttar Pr.	24	67	512	191	29	138	19	20	1000
Uttaranchal	315	48	398	59	17	149	0	14	1000
West Bengal	103	192	285	130	107	154	7	23	1000
Group of UT's	307	147	136	103	61	245	0	1	1000
All India	25	196	356	257	52	85	9	21	1000
Estimated Number (00)	14769	114785	117100	125000	53902	77602	7181	14605	434242
Sample Number	992	5844	6296	6919	3018	4528	345	872	23935

Source: RBI Report 2007

The above data reveals that out of every Rs 1,000 outstanding of farmer households in the country, Rs 257 was sourced from moneylenders. The share of moneylenders in the indebtedness of farmer households in Bihar, Manipur, Punjab, Rajasthan, Tamil Nadu and Andhra Pradesh were well above the national average, with Andhra Pradesh at the top. The penetration of moneylenders is significant even in States that are regarded as being adequately banked (Andhra Pradesh and Tamil Nadu).

CHARACTERISTICS OF INFORMAL CREDIT

Different common characteristics of informal credit are discussed in the following.

Mode of Operation: The informal moneylenders maintain a close interpersonal relationship with the borrowers. The informal approach, round-the-clock availability of finance has made them the most important lenders in the villages. Their policy of anytime, anywhere, any amount, has strengthened their position in the villages, thus reducing the role of banks.

Size of the Loans: The average size of the loans generally varied widely from Rs.1000 to Rs.50, 000.Even Rs.100 is also given.

Purpose: the loans provided are generally short-term in nature, and for the purpose of mainly consumption and meeting social obligations like weddings, birth and death ceremonies, treatment of illness etc.

Security Obtained: Mostly, loans are granted against the security of gold jewelry, landdocuments, cultivationrights, utensils etc.Many informal lenders give loans without any security and with only signature in their cashbook register for having taken the loan.

Rates of Interest: The rates of interest charged by the informal credit agencies ranges from 36 percent to 144 percent per annum.Generally the input suppliers do not chargeany interest explicitly, though such interests are subsumed in the price of inputs itself.

Collection of Interest: There is no fixed or specific period for collection of interest by the lenders. They are following their own practices which are binding for the borrowers.

The characteristics of Informal Credit that goes against the interest of the debtors:

1. The interest rates are high, sometimes very high. It ranges from 36 percent to 144 percent. It is a typical feature of backward agrarian economy. Moneylender’s monopoly power arises from his intimate knowledge of the borrowers circumstances. It is therefore very difficult for other creditors to penetrate that local money market.
2. The borrowers have to repay the loan when a lender asks for repayment of the loan or a part of it. Debtors are to borrow further from other sources if he cannot manage to satisfy the creditor.
3. Debtors sometimes lose their mortgages that they are compelled to deposit for having failed to repay the loan taken in a distressed condition.

4. Borrowers generally cannot take loan from other creditors than from the creditor he has taken loan earlier in the fear that the previous creditor may not give loan in future if required. Therefore, debtor has no option but to take loan, if needed, from the person he has taken loan earlier.
5. Debtors and his family members are sometimes assaulted by the creditors when they fail to repay the loan on the condition set by the creditors.

REASONS FOR CONTINUED DEPENDENCE ON MONEYLENDERS:

The Technical Group of RBI has identified some reasons for which informal credit is continuing. They are namely-

1. Limited outreach of formal credit: The formal credit agencies could not reach to the villages as such. They are mainly urban and semi-urban based. Besides the credit delivery system of the formal banking is very cumbersome. The formal credit system lacks personal bonds that the informal agencies maintain.
2. Moneylenders do business at the doorstep: Borrowers do not require going to the lenders repeatedly for a loan. Once the moneylender comes to know the requirement he comes to the doorstep of the borrowers. Besides, there is no requirement of cumbersome form fill-up and other requirements to get loan as it is in case of formal credit agencies like bank.
3. Inadequate and delayed credit: Delay of sanctioning loans by the banks often forces the borrowers to approach moneylenders even though theycharge much higher interest rates. The requirement of the loan sometimes becomes so emergent issue that the borrowers cannot wait. And, as the moneylenders are very swift to lend the money, borrowers do not have the option to wait for the formal banking loan. On the other hand, interest rates of the informal credit agencies are so high and the repayment method is so coercive that the borrowers give high priority to repay the loan, and, to come out of it. As a result, bank loans become overdue, and sometimes turn into Non-Performing Assets (NPA).
4. Banks do not like to deal with marginal farmers: The marginal category covers 50 per cent of the farmers. They do not get loan from the banks, and, are therefore compelled to approach moneylenders for their needs.
5. Institutional credit agencies insist on collateral before advancing a loan. For poor peasants this makes formal credit as infeasible option.

ROLE OF INSTITUTIONAL BANKING AND FINANCIAL INCLUSION IN INDIA

The concept of financial inclusion can be traced back to the year 1940 when co-operative movement took place in India. It gained momentum, as it is mentioned earlier, in 1969 when 14 major commercial banks were nationalized in the country and lead bank scheme was introduced shortly thereafter. Branches were opened in the semi-urban and rural areas where it was neglected hitherto. Still, a large section of the population was not covered under institutional banking. There is a considerable gap in the financial access which needs special attention. Even from the study of the World Bank it is found that about 40 percent of the households have deposit account, 20 percent have outstanding loans and only 15 percent have any insurance Basu[7]showed.

Policy of financial inclusion among poor farmers is a high priority for Indian policy makers Lahiri and Mookherjee[8] stated. Financial non-inclusion causes financial distress for the rural poor limiting their ability to raise productivity, grow high value crops and improve their own standard of living.

Financial inclusion is meant to include all the sections of the society, who are mainly out of the net of the financial institutions. On the other hand, financial exclusion is meant the lack of access by certain sections of the society to low cost, fair and safe financial products and services from mainstream providers, Chattopadhya[9] argued. There are demand side and supply side reasons of financial exclusion. The demand side reasons are lack of awareness, low income, requirement of collateral, poverty and illiteracy. The supply side reasons are distance from the branch, branch timings, cumbersome application procedure and documentation, language, staff attitude etc. Due to all these procedural hazards, people feel it easier to take money from informal credit sources, but it results in compromised standard of living, higher costs, and increased exposure to unethical and unregulated providers and vulnerability to uninsured risks.

Efforts to bring the poor underprivileged within the formal banking system have been going on for a long time. Both the Government of India and the Reserve Bank of India have taken different steps to execute this. The role of commercial bank in terms of financial inclusion has been extremely well, though mainly in urban areas. RRBs and co-operative banks have covered mainly rural population and are considered to be the providers of financial access at a low interest rate to semi-urban and rural households. More than 60,000 branches of commercial banks and more than 1, 00,000 primary agricultural credit societies (PACs) are functioning apart from several others financialinstitutions. The share of offices in the rural and semi-urban together areas has increased from62.6 per cent to 68.0 per cent in 2005. The share of deposit and credit in rural and semi-urban areas is on the decline. The share of deposit is higher than that of the credit in all the regions except metropolises. This implies that resources are channelized to metropolitan areas.

PRIMARY HOUSEHOLD LEVEL SURVEY OF TWO VILLAGES

A household level primary survey of two villages from different Blocks of Birbhum district, West Bengal has been undertaken. From each village 100 households have been met with a structured questionnaire using codes. After decoding the collected data a part of that related with the topic has been analyzed, and the data has been used in the following Table.

It can be noticed from the Table 2 that though there has been a considerable jump in the per capita deposits and credit in all the states in India, however, there has been variability among the states. The C-D ratio has been very high in all the southern states while it has been low in almost all the eastern states.

Table 2: Loan taken by the households (Source-wise)

	Sources of loan	Freq.	Percent
Private	Landlord	16	11.43
	Professional moneylender	68	48.57
	Trader	42	30.00
	Relatives & Friend	5	3.57
	Others	9	6.43
	Total	140	100.00
Institutional	Co-operative/Bank	8	24.24
	Commercial Bank	23	69.70
	SHG	2	6.06
	Total	33	100.00
Total number of loans taken		173	

Source: Field Survey

From the above Table it is clear that number of households taken loan from the private sources is much higher than the number of households taken loan from the institutional sources. Number of households taken loan from institutional sources is only 33 of the two villages taken together. Though, maximum number of loan has been taken from scheduled commercial banks. So, it can be said that commercial banks have the largest coverage (near 70%) within the institutional sources of credit.

The number of households taken loan from the private sources is140 of the two villages taken together. Out of these 140 households 68 (i.e. 68%) of them have taken loan from professional moneylenders. Therefore, professional moneylenders are still the biggest source of private loan in West Bengal. Then, the position of the traders. Traders have emerged as principal suppliers of inputs of credits during the last 20 years, Deb and Rajeev[10] examined. The traders supply both necessary consumption goods and inputs like fertilizers, pesticides etc. They are also important source of private finance in rural West Bengal. Landlords are relatively less important source of finance in the state. Relatives and friends are least important as a source of money within the villagers.

It can be concluded from the above analysis that, informal sources are the predominant sources of finance in the agrarian economy of West Bengal. Formal sector is far behind to be inclusive in the state.

Therefore, both from the secondary and primary sources of data, it can be concluded that, private sources of credit is the predominant source of finance in West Bengal as well as in India.

CONCLUSION AND POLICY IMPLICATION

After bank nationalization, though social and development banking expanded in a considerable manner, but informal sector sources of finance continued its part activities as formal sector could not have covered specially in the rural areas. It has not been inclusive enough to cover all the sections of the people, especially weaker section of the population. As getting loan from the formal sector is cumbersome and time-consuming, people particularly poorer people prefer to take loan from the informal sector. Besides, banks do not give consumption loan which the poor farmers require. Therefore, they do not have alternative to surrender to the informal agencies like moneylenders, traders etc. in spite of the fact the interest rates charged by informal agencies are much higher than the formal sources of credit. Apart from that, moneylenders, traders give credit without collateral as they are quite acquainted with the borrowers. The personalized relations of the possible borrowers with the lenders act as collateral of the transaction. The amount of required is so small in magnitude and asked for so exigency situation that formal agencies cannot comply with that. Therefore, informal agencies of finance are so much acceptable though may not be popular in the agrarian economy of India and also in West Bengal.

As policy implication, it can said that formal agencies like bank should make its loan advancing method more flexible and less cumbersome such that weaker sections of people can approach for institutional loan. Besides, people are not always aware of the facilities that social banking offers. Concession and subsidies that are offered with the small loans, poor people like landless laborers, marginal farmers, artisans etc. even are not informed. Even if they are informed, the staff approach is not conducive to those people to approach for the loan. Therefore, staff should make a sort of personal relation with the people of the locality such that they don't fear to go to the bank and approach for loan or something else. Bank can meet twice or more with the people of the catchment area and inform people about latest offers bank provides. Moreover, banks should think of extending even consumption loan in flexible manner on the basis of personalized relations made between the village people and bank officials. Lastly and most importantly, banks should extend their branches manifold to extend banking services covering hundred percent citizens of the country without considering profitability criteria rather as a social and patriotic responsibility.

Side by side, laws to protect creditors from unlawful action and extortions of the private moneylenders should be implemented strictly to protect dignity of people, even he or she is a debtor.

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