Rural Credit - Sources and Limitations

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Abstract

With India's independence, the country's rural credit system underwent major structural modifications to improve access to and utilization of loans. The goal of this research is to analyze the post-independence evolution of rural lending in India. Using information collected by the Reserve Bank of India in 1951–1952 and 1961–1962, as well as the All India Debt and Investment Survey performed by the Government of India, this research analyzes three critical characteristics of rural credit: access to credit, credit use, and credit supply. The analysis, which is based on data from the federal and state levels, uses decadal growth rates to explain the changes in rural loans. Both the total volume of loans and the total number of indebted households are at all-time highs. The significant increase in debt, though, is cause for alarm. Since liberalization, there has been a steady decrease in the proportion of credit extended by institutional agencies. Due to their adaptability, borrowers continue to favor non-institutional services like professional moneylenders when looking for a loan. Fascinatingly, microfinance has become a significant source of financing for low-income rural communities. Another major issue is the growing trend of low-income families using credit for non-work related purchases.

Keywords: *Rural Credit, Sources, Limitations, Rural credit, Challenges.*

1. Introduction

There have been major structural shifts in the Indian Rural Credit sector since independence. When the country initially won its independence, moneylenders, traders, and rich landowners filled much of the rural populace's credit demands. Many regional banks were founded, private banks were nationalized, and credit cooperatives were established as government responses to the problem in the 1950s and 1960s (Sriram, 2012). The effectiveness of the agricultural credit distribution system was greatly enhanced with the establishment of the National Bank of Agriculture and Rural Development (NABARD) in 1982. A significant portion of the rural population still lacks adequate access to financial resources notwithstanding these efforts (Abaru, 2006).

Being a source of income for roughly 70% of the population, agriculture's significance cannot be overstated. The Indian peasant is notorious for being impoverished,

uneducated, and indebted. The Central and State Governments of India have instituted regulations on money lending, placed restrictions on the sale of agricultural land to non-farming classes, and provided direct financial aid in the form of taccavi loans in an effort to alleviate agricultural debt. Despite the government's best intentions, the agricultural masses' economic situation has worsened and their debt has climbed significantly over the years (Baquedano, 2006).

Cooperative Credit Societies and Banks

The agrarian is a vulnerable target for economic and moral decay, but the cooperative movement aims to shield its members from both while stressing the value of mutual aid. The passage of the Cooperative Credit Societies Act in 1904 is often cited as the starting point of the cooperative movement in India. A major turning point in the development of the cooperative movement in the United States occurred in December 1954 with the release of the Rural Credit Survey Report. The Government of India adopted many of the Report's suggestions, and it sent directives to the individual state governments instructing them to create plans for expanding the cooperative sector throughout the plan's timeframe. The Second Five Year Plan called for the establishment of a three-pronged, integrated rural finance framework (Meyer, 2011).

- Multi-tiered state collaboration
- Integrated management of all marketing, processing, and credit operations
- A capable government that listens to and serves the people living in rural areas.

Regional Rural Banks

The establishment of rural banks was suggested by the Banking Commission in its 1972 report to the Government. These rural banks were defined as the major financial institutions for communities of between five thousand and twenty thousand people. The government was eager to establish rural banks rapidly so that rural debt could be promptly eliminated (Reddy, 2006). Hence, on September 26, 1975, the Regional Rural Banks Act was passed into law and became immediately effective over the entirety of India. The Act established Regional Rural Ranks to offer funding and other amenities to small and marginal farmers, agricultural laborers, craftspeople, and small business owners in rural districts. One or more rural banks may be established in a State or Union Territory by the Central Government at the request of any bank, often the Lead Bank of that region, also known as the sponsor bank. Every rural bank will serve its immediate community. A rural

bank may, if deemed essential, open additional offices anywhere the government provides notice (Srinivasan, 2011).

2. Research Methodology

The Reserve Bank of India (RBI) commissioned the first in-depth research of rural credit in 1951–1952 to examine the relationship between the demand for and supply of credit among rural families and credit organizations (both formal and informal). A report titled "All-India Rural Credit Survey" containing the study's results was published in 1954. Information was collected on assets, economic activities, specifics of credit operations, and the incidence of indebtedness (IOI) in rural India, as well as the breadth and style of operations of different credit agencies in providing the loan. Another survey with similar questions was conducted in 1961–1962.

The second survey broadened its scope to measure rural economic indicators such as household capital expenditures. All India Rural Debt and Investment Survey was the name given to the 1965 report detailing the results (AIDIS). The NSSO was given responsibility for further polling. With the most recent one being in 2012, this organization has now performed five decadal surveys. All of these analyses set aim to achieve the same thing: compile information that may be used to inform regional development strategy, such as the asset stock, IOI, capital production, and other indicators of rural and urban economies. To the extent possible, the surveys were designed such that their estimates would be comparable to those of previous rounds. This analysis of rural credit trends makes use of data from the AIDIS survey reports on such topics as credit availability, credit sources, and credit use.

Credit availability is measured by looking at IOI data and average household outstanding debt. Percentage changes in decadal growth rates shed light on patterns. The source of credit is examined by looking at how the percentage of loans made by various institutions and non-institutions has changed throughout the years. Finally, we infer shifts in the pattern of credit use by looking at how families as a whole and by decial class utilize credit for a variety of purposes.

3. Result Analysis

Since independence, the government has prioritized providing the rural people with access to sufficient finance to meet their many needs. The government's actions in this arena are being broken down into three categories: access to credit, the availability of credit, and the use of credit.

Availability of credit

Rural economies across the world, including rural India, have been characterized by credit restriction or an inadequate provision of credit. Yet, there has been a considerable increase in the accessibility of loans in the rural economy. The quantity of household debt as well as the number of households with debt is shown in Table 1 for the years 1971 through 2012. Although there were 31.80 million indebted households in 1971, just 18.20 million were still struggling with debt by 1981. At that point, the number steadily increased, from 39.2m in 2001 to 56.40m in 2012. In 1971, 41.3% of all families were considered to be in some form of debt, but by 2012, that number had dropped to only 31.4%.

Table 1: Rate of debt accumulation and current debts (all India)

Year	The Indebtedness Incidence Rate (IOI%)	Millions of homes total	Total household debt as a percentage of income (in nominal	The Real Average Household Debt (in R)	Defaulting households have, on average, a nominal debt load	Defaulting households have, on average, a real amount of debt
1971	41.30	31.80	500	10,060.36	1,180	23,742.45
1981	19.40	18.20 (−74.74)	661 (24.35)	5,413.60 (−85.84)	3,411 (65.43)	27,936.12 (15.04)
1991	23.40	27.20 (33.08)	1,906 (65.33)	6,666.67 (18.80)	8,166 (58.42)	28,562.43 (2.17)
2002	26.50	39.20 (30.63)	7,539 (74.73)	12,980.37 (48.66)	28,443 (71.29)	48,972.11 (41.69)
2012	31.44	56.40 (30.50)	32,522 (76.88)	30,216.48 (57.07)	103,457 (72.51)	96,122.83 (49.08)

One distinctive feature of rural lending is the growth, both nominally and in real terms, in the average outstanding debt (AOD) of rural families. When a family's income rises, so do their expenses; from Rs 500 in 1971 to Rs 32,522 in 2012, on average. From a decadal growth rate of 65.32 percent in 1991 to 76.82 percent in 2012 is a significant increase. There has also been an increase in the typical annual consumption of AOD by a household. In terms of current Indian rupee values, between 1971 and 2012, the average annual income of a family has climbed from Rs 10,060.36 to Rs 30,216.48. Surprisingly, the AOD numbers show a significant increase from 2002 to 2012 when just the indebted families are evaluated. In 2012, the average outstanding debt (AOD) per indebted family was Rs 103,457, up from Rs 28,443 in 2002.

Sources of credit

Post-independence rural credit policy has prioritized institutionalizing rural credit and expanding the reach of formal institutions to more people in rural areas. Several structural shifts in the rural finance sector have been implemented throughout time in pursuit of this goal. The most important was the nationalization of banks in 1969, when the government took over 14 banks that held 70% of the country's deposits. The official and informal organizations that contributed to the NSSO surveys conducted between 1951 and 2012. As a result of bank nationalization and the establishment of additional institutions like the cooperative society and regional rural banks, the percentage of institutional agencies climbed from 7.2% in 1951 to 61.2% in 1981. In 1991, their percentage peaked at 64%, but has since been on the decline. The abrupt rise in the number of rural lending institutions has been blamed for at least some of the decline. As a result, there was a lot of duplication and inconsistent lending in rural regions, which drove up fees.

Poor service was also the result of an inadequate workforce in relation to the volume of loan activities. Commercial banks have relatively high transaction costs, averaging 6%-7% of loan proceeds. Due to a decline in rural banking network, these banks have moved their attention to pick major borrowers, excluding the rural poor in the process. The percentage of non-institutional agencies has increased from its all-time low of 36.1% in 1991 to its current level of 43.9% in 2012. When it comes to rural finance, moneylenders are by far the most significant non-institutional agency. Several types of stakeholders include direct lenders, input/consumer good suppliers, end-product purchasers, and landowners.

Table 2: Distribution of Rural Loans (all India)

Credit agencies	1951	1961	1971	1981	1991	2002	2012
Administrative bodies (A)	7.3	14.8	29.3	61.3	64	57.1	56.2
Government	3.3	5.4	6.7	4	5.7	2.3	1.2
Bank or cooperative society	3.1	9.1	20.2	28.5	18.8	27.4	24.9
Retail and Wholesale Banks	0.8	0.4	2.3	28	29	24.5	25.2
Insurance			0.1	0.4	0.5	0.3	0.2
Provident fund			0.1	0.4	0.9	0.3	0.2
Corporation or Financial Institution							0.7

Financial company							1.1
Funding for mutual aid organizations							1.9
Self help group – NBFC							0.4
Different Governmental Bodies					9.3	2.5	0.8
Organizations Outside of Government (B)	92.8	85.3	70.4	38.7	36	42.8	43.7
Landlord	1.5	0.9	8.6	4	4	1	0.7
Agricultural moneylenders	24.9	45.9	23.4	8.5	6.4	10	5
Experts in lending money	44.8	14.9	13.8	8.3	9.4	19.8	28.3
Input supplier	5.5	7.7	8.8	3.4	7.1	2.6	0.1
Relatives and friends	14.2	6.8	13.8	9	6.7	7.1	8
Others	1.9	8.9	2.8	4.9	2.5	2.6	1.9
All (A+B)	100	100	100	100	100	100	100

The 2012 AIDIS report expands the definition of "institutional agencies" to include both "Self Help Group-Bank Linkage" and "Self Help Group-NBFC." These organizations are examples of two well-known types of microfinance programs in use in India. Due to the short history of microfinance institutions (MFIs) as a loan granting agency, no relevant microfinance statistics can be found in AIDIS reports before 2012. The Reserve Bank of India has been highly encouraging of the expansion of microfinance in India, despite the fact that it has met just 2.2% of the country's credit needs as of 2012. In the absence of a governing framework, in 2000 the RBI issued notices empowering banks to establish their own policies and procedures for microfinance. The banks were allowed leeway to develop their own microcredit delivery strategy or middleman. The lack of stringent standards for qualifying MFIs was another way in which RBI encouraged their expansion. The interest rates on both MFI loans and customer loans were uncapped.

Uses of credit

Credit must be used wisely if the agriculture sector and the rural economy are to flourish. Reports on the utilization of credit from 2002 through 2012 show a sizable proportion of total credit being redirected to consumer purchases. This ends up being a significant problem for rural finance. Table 3 illustrates that the percentage of outstanding debt that was used to generate revenue fell dramatically between 2002 and 2012. In 2002,

a significant 52% of the credit was put to use producing revenue, but by 2012, that percentage had dropped to 40%. Spending on farming-related activities has dropped significantly. While 38% of the credit was put toward farm-related capital and operating expenses in 2002, only 28% was spent that way in 2012. As a result, financial assets have grown, but a sizable portion of the available credit has been redirected to endeavors that generate no return. In 2012, the most common uses of credit were for mortgage payments (20.5%) and medical care (6.1%). The percentage of income allocated to debt payments has similarly increased, from 2% in 2002 to 2.6% in 2012. This is not a good indicator in any way. Borrower hardship will continue to rise as a greater share of available cash is used for expenses rather than revenue generation. This is due to the "fungibility" of credit, which states that any given monetary unit (whether owned or borrowed) can be treated as equivalent to any other monetary unit.

More liquidity is provided by the loan funds, which are then invested in the most profitable opportunity, as seen through the lens of the borrower. As a result, policymakers are unable to prevent households from using inexpensive concessional loans granted by institutional entities for purposes other than those intended. In addition, the execution of debt contracts leads to the impoverishment of borrowers due to the lack of repayment ability caused by the absence of productive prospects. The evaluation of the success of the credit program is further complicated by fungibility. But there's no reason to think we shouldn't consider credit project effects in the context of rural credit performance as a whole, rather than at the level of individual households or farms.

Table 3: Variations in Credit Use in Rural India between 2002 and 2012

Items	2002	2012	Growth rate
Expenditure in farm business	38	28.6	−24.75
Personal consumption	14.4	11.2	−19.15
Household spending	47.8	60	25.25

Breakdown of family credit utilization by asset type in 2012. There is a large gap in the data between the wealthiest and poorest households. Credit use for revenue generation varies widely throughout the socioeconomic distribution, from 15.4% in the lowest decile to 55.5% in the highest. The poorest 40% spend over 80% of their debt on necessities at home. Since a larger proportion of the borrowing of families in the lowest income decile originates from non-institutional organizations charging comparably higher interest rates, the amount of hardship increases. Table 4 gives a deeper dive into how families use credit, showing that the lowest asset class households spend 11.1% of their credit on loan

repayments (both current and old). This is a far higher percentage than the other nine deciles, which normally only spend 1.5% on debt payments. The money they earn goes toward meeting their most fundamental needs, such as providing for their kids' schooling, shelter, healthcare, and entertainment needs for special occasions like holidays and festivals.

Table 4: Cash loans to rural Indian households, broken down by asset type and loan purpose (2012)

Distribution of Household Wealth under the Decile System	Farming related costs	Investment in Non-Agricultural Enterprises	Household spending
1	9.4	6	84.6
2	7.7	3.7	88.6
3	8.1	5.5	86.6
4	13.3	4.7	82.3
5	16.5	6.1	77.2
6	20.2	7.4	72.2
7	32.5	5.9	61.6
8	31.1	5.6	63.4
9	37.3	7.4	55.5
10	34.4	21.3	44.6

But they also need to take appropriate action to stop the debt waiver programs from becoming a routine periodic exercise, as is now the case. The credit system will suffer as a result of the increase in intentional defaults and the moral hazard problem. If politicians meddle too much with how institutions work, it might threaten their very survival.

4. Conclusion

From the 1950s onward, rural credits have been the focus of governmental action in developing nations. Many of these countries, notably India's, have invested heavily in various forms of providing low-cost loans to the rural populace. Several of these efforts have yielded less than desirable results. Public credit organizations were unable to replace the traditional moneylender or lower interest rates because of government regulations based on a misunderstanding of how rural loans work. Rural credit is doubled in the context of developing countries. The absence of collateral assets is the fundamental barrier to rural lending, as stated by Chandavarkar (1965). Lenders must have faith in their borrowers' ability and integrity, rather than in tangible assets, since there are no such things as collaterals. However this has led to widespread rural poverty and exploitation as

a result of a growing debt load. Recent governmental measures and the drive toward a digital economy are positive developments, but a great deal of work remains.

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