Rural Credit in India in Peril

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October 2005

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A Review Article

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Financial Liberalization and Rural Credit in India
edited by V.K. Ramachandran and Madhura Swaminathan
Tulika Books, 2005. India.

At a time when the `idea of development banking' in India as elsewhere in the world has been rejected from mainstream financial policy discourses, except perhaps as benchmarks for the perceived success of neo-liberal reforms, the collection of papers in this volume present an uncompromising stand on the need for development banking. Based on a rich array of theoretical reasoning and empirical evidence on the impact of liberalization of banking policy and structure on the rural economy the authors demonstrate that the reversal of the policy of development and social banking has contributed in no small way to extreme deprivation and distress among the rural poor. Such an assertion, while often heard in the recent years, had lacked a systematic body of well-researched evidence in support. The extensive combination of both macro and micro evidence put together in this volume provides a solid reference point to seriously question the conviction of neo-liberal reforms to `throw the entire structure of social and development banking overboard'. (p. xxiv)

The case for development banking rests on two fundamental perspectives that inspired financial policy in India, particularly during the post-nationalization banking phase. The first is the notion that *finance should be subordinate to the needs of the real economy such that the financial sector serves the needs of development.* (Patnaik, 1999) This had necessitated Indian financial system's three main features, namely, its being anchored to the national economy and detached from world financial flows; its being obliged to give precedence to production over speculation; and its being accountable to the people via the government. The second perspective that was instrumental in shaping public policy on banking in India takes as its starting point the divergence between social returns and private returns in credit markets to infer that *controls on price and direction of credit are necessary to drive the economy towards a socially desirable optimum.* Financial development could neither be left to market forces nor to the initiative of private forces. Rather, State as an embodiment of social rationality was deemed as the suitable agency for intervention. This view underscored several important aspects of financial policy such as: low interest rates; directed credit to the priority sectors; nationalization of banks and branch expansion; creation of special development banks; and segmentation of banking from stock markets.

Both these perspectives have been superseded in the recent decades; we briefly look at how.

International Capital Flows and Economic Sovereignty

The massive cross-border capital flows, co-terminus with globalization today, have reversed the relation between finance and the real economy. No longer is finance subordinate to the needs of the real economy. There has been a general shift of capital out of production and into the financial sphere, much of which is unproductive and speculative. This form of capital gives its owner a capitalised stream of future revenue but for which there is no real asset backing. From the perspective of the developing country then, capital flows have failed to improve the allocation of global capacity by moving resources from capital-rich to capital-poor countries, and have only produced opportunities for savers, not lower costs for borrowers.

On the other hand, capital mobility has imposed three major types of costs on the developing host nation. The volatility of capital flows has increased real economic instability. It has constrained governments from adopting autonomous monetary policies. And the threat of capital flight has led to deflationary macroeconomic policies. As a result the nature of the State is fundamentally altered today. "From being an entity standing apart from and above society, embodying a higher rationality than the participants in economic life of the society, and using that for pervasive intervention in economic life, the State is now seen as an agency that should exclusively promote the interests of finance capital." (Patnaik, 2005)

The opening essay of the present volume by Prabhat Patnaik emphatically establishes that this very regime of unrestricted capital mobility and the attendant constraint on economic sovereignty underlies the present controversy surrounding fiscal deficit and interest rate in India. It's been repeatedly pointed out by the proponents of neo-liberal reforms that fiscal deficit has contributed to higher interest rates in the Indian economy, thereby vitiating some of the proposed gains of financial liberalization, namely, lower cost of capital for the domestic investors. In an earlier paper, which generated significant debate, Patnaik (2001) had demonstrated that the fiscal deficit has no direct bearing on the level of interest rate particularly in a demand constrained situation, and therefore the proposition that the fiscal deficit must be cut in order to lower the interest rate lacks theoretical justification.[1] The present essay proposes that the imperative of providing a higher real return on capital in the periphery vis-à-vis the metropolis in a regime of liberalised capital flows accounts for the higher real interest rates in countries such as India. For a sample of developing economies, Patnaik finds that the interest rate differentials between the periphery and the metropolis are not only meant to offset the expectations of real exchange rate depreciation but must necessarily account for the higher risks of investments in the periphery as perceived by the international investors. Thus, the level of interest rate, the key variable in the financial markets, becomes an instrument not to meet domestic monetary and credit targets bearing on real economic growth and employment, but is determined by the constraints of opening up the economy to freer movements of globalized finance.

Neo-liberal Attack on Directed Credit Policies

The neo-liberal attack on regulation of interest rates originated with Ronald Mc Kinnon's (1973) well-known characterization of developing country banking systems as `financially repressed'. Beginning with this characterization, Mc Kinnon and other mainstream theorists proposed an alternative of higher saving and higher investment through a general freeing of interest rates. In the specific case of rural credit where the felt need for controls on price and direction of credit is stronger both from the point of view of allocative efficiency and redistributive objectives so that an entire host of developing countries in the 1950s and the 1960s initiated various types of directed credit programmes, a case for paradigm shift to `market approach' is constructed around the sectoral terms of trade debate.

[1] See Deena Khatkhate and Dan Villanueva's response to Patnaik (2001) published in Economic and Political Weekly, May 12 and July 28, 2001.

The starting point of this argument is that the directed credit programmes were cast in a decidedly unfavourable market environment. They were directed to an agriculture sector that was experiencing strongly negative terms of trade. The combination of unfavourable exchange rate regimes, punitive export/import taxes and tariffs, as well as domestic commodity price controls depressed earnings in agriculture. It is to make up for the distortion in output prices in the farm sector, it is argued, that another distortion was introduced in the form of directed and subsidized credit programmes. With structural adjustment of the economies, as terms of trade for agriculture improve, and as many governments shift from `import substitution' and `punitive' policies towards a more positive economic policy framework for agriculture, the need for state interventions through directed and subsidized credits automatically withers.

This argument located in the urban bias framework, and fired by the logic of getting the prices right has scant empirical support. In the Indian case, the low price elasticity of agricultural supply even in the long run meant that the urban bias thesis was never seriously entertained by most Indian economists. (see Rao and Storm, 1998).[2] The contrary evidence notwithstanding, the neo-liberal hegemony has doggedly pushed the market approach to rural credit with market determined interest rates and lack of restrictions on portfolio choice as both necessary and sufficient to ensure flow of credit to the rural sector and to maintain the viability of the financial institutions (FIs). As for reaching credit to the poorer sections in the rural areas, the high rates of interest prevailing in the informal credit markets is taken as indicative of the willingness of the borrower to pay the market-determined interest rate. High transaction costs rather than market imperfections are construed as the main reason why the banks are unwilling to lend to income poor households. It is possible to solve the problem of high transaction costs, the market approach claims, through innovations such as the micro-credit programmes. This model promoted by Fund-Bank economists and backed by institutions such as FAO, portrays the directed and subsidized credit programmes as both redundant and wasteful, and argues that market-approach to rural credit can achieve more efficiency and more equity at the same time.[3] To what extent is this optimism borne out by the Indian reform experience?

The Era of Social and Devleopment Banking in India and Beyond...

The Indian experience of social and development banking began in 1969 with the nationalization of fourteen major commercial banks. The declared objectives of the new policy with respect to rural banking were: (i) to provide banking services in previously unbanked or under-banked rural areas; (ii) to provide substantial credit to specific activities, including agriculture and cottage industries; (iii) to provide credit to certain disadvantaged groups, such as, dalit and schedule tribe households. (Ramachandran and Swaminathan, p. xxiii) In accordance with these objectives, a multi-institutional approach to credit provision in the rural areas with commercial banks, regional rural banks and cooperative institutions became a policy. Branch licensing policy was introduced to expand the operations of commercial bank branches in the rural areas. Banks were required to implement schemes of sectoral targeting in the form of priority sector lending. A target of 40 percent of advances for the priority sectors, namely, agriculture and allied activities, and small-scale and cottage

[2] Oya (2004) cites similar evidence for other developing countries.
[3] See FAO and GTZ (1998)

industries, was set for commercial banks. For the various priority sectors, the RBI prescribed a certain ceiling rate of interest for every size-class of loans. After 1980, commercial banks also became the agencies through which the government directed subsidized credit to the rural poor for the creation of income-generating productive assets.

The success of these policies in terms of branch expansion, mobilization of household savings, diversification of lending targets, and direction of credit to the priority sector was substantial. The expansion of commercial banking in terms of geographical spread and commercial reach was unparalleled in financial history. In 1969, banks provided only 14.6 percent of their total credit to the priority sectors, and the percentage of credit disbursed to agriculture was as low as 5.4 percent. In 1991, the respective shares had increased to 40.9 percent and 16.4 percent. Undeniably, there were several weaknesses in the banking system, which S.L.Shetty argues were `a natural corollary to the most rapid expansion ever undertaken in banking industry anywhere in the world.' (p.54) These shortcomings being mostly organizational in character, what was required was to correct management weaknesses and to confer a greater degree of managerial and organizational freedom to banking institutions, which an indigenously generated reform process could have addressed. Instead, standardized prescriptions for financial liberalization of the multilateral agencies were enacted on the recommendation of Narasimham Committee ignoring the enormous role played by banks in economic development.

The Indian financial reform strategy at the beginning of the 1990s involved four major initiatives. (Chandrasekhar and Ray, p.12-14) First, in order to increase the credit creating capacity of banks reductions in the statutory liquidity ratio and cash reserve ratio were effected. Second, in order to increase competition among FIs, structural changes were brought in. This included broadbanding of financial services by commercial banks and development finance institutions, reverse-mergers of development finance institutions or their mergers with banks, allowing entry to private and foreign banks and raising the cap on foreign direct investment in private banks. Third, banks were given greater freedom in determining their asset portfolio. They were permitted to breach the firewall that separated banking sector from stock market and also allowed a greater leeway in altering priority sector lending targets. Fourth, in order to protect the system from destabilizing forces concomitant with deregulation, the government specified new capital adequacy norms for banks, prescribed guidelines for bad debts, and injected massive funds towards the recapitalization of public sector banks.

These overall financial reform measures were supplemented by a `reversal' of rural banking policies. The definition of priority sector was diluted by raising the credit ceiling limit, and by widening the coverage to include many hitherto non-priority sector heads. At the same time, non-fulfilment of priority sector target was overlooked and commercial banks were provided the easy option of meeting the shortfall in priority sector target by investing in special bonds issued by certain specialized institutions. Except for the narrow segment of small borrowal accounts, interest rate regulations under the priority sector were removed. Branch licensing policy instrumental in the expansion of commercial bank branches in rural areas was modified to allow banks to rationalize their branch networks.

Rural banking in India now had to compete on an equal footing on market principles as commercial banking. The objective of allocative efficiency of investment in the economy, the guiding principle behind social and development banking, was replaced by the objective of operational efficiency of individual FIs. Writing in the initial years of the reform phase, Rakshit (1994) had warned that `under the free play of market forces investment in banking will be sub optimal due to the wide gap between social and private returns on the extension of banking services to the unorganised enterprises. The gap between the two returns will be wider, the larger the endowment of resources in the informal sector; the more the resources are area specific or immobile; the greater the imperfections in the markets for factors and products; and the more important the impact of credit extended by a bank on the deposit mobilisation of or demand for credit from other banks.’ Inadequate banking facilities to producers in the unorganised sector will thus act as a serious constraint on economic growth. The massive evidence of disintermediation of the rural borrowers witnessed over the subsequent years and presented in this volume shows that the worst fears have come true.

Sectoral and Regional Distribution of Credit in the Post-Reform Era

The overall impact of these banking policy changes on the quantum and distribution of institutional credit in the rural areas have been examined at length in the three papers by Chandrashekar and Ray, Shetty, and Chavan. Their analysis, based on macro-level data, unequivocally indicates that banking sector liberalization has resulted in a reversal of the process of balanced development of banking in India. `All the distributional goals —regional, sectoral, functional, and by size —in respect of one of the most potent instruments of decentralized, dispersed and egalitarian development, namely institutional credit stand jettisoned in the post-reform period.’ (p.71)

To ensure adequate institutional credit supply to the farm sector and achieve sectoral balance in its distribution, scheduled commercial bank advances to agriculture had been placed under priority sector lending. Accordingly, the annual growth in agricultural advances was 17.22 percent between 1975 and 1980, and 8.84 percent between 1980 & 1990. During the past decade, annual growth of agricultural advances fell to an abysmal 2.2 percent. As a percentage of net bank credit, agricultural advances of scheduled commercial banks declined from 16.4 percent in 1991 to 11.6 percent in 2003, which is only 2/3rd of the stipulated 18 percent RBI norm. Further, the fact that the commercial banks over the same period also reduced their credit exposure as a share of total earning assets (credit and investment) means that the agriculture sector received a lower share from an overall shrinking pie. Between mid-1990s and the year 2000, the number of agricultural loan accounts with scheduled commercial banks declined by a whopping 17 percent, a burden largely shouldered by marginal and small cultivators. Their share in total direct advances of scheduled commercial banks vis-à-vis all cultivators declined sharply. Another disturbing trend has been the low, and even negative growth of term-lending to the farm-sector. (RBI, 2004) Such severe credit starvation of agriculture has no doubt significantly intensified the agrarian crisis in the post-reform period with its features of low sectoral GDP growth, low employment growth, stagnation of investment and extreme distress of the marginal and small cultivators.

An almost identical picture emerges in respect to deceleration of institutional credit to village and small-scale industries with adverse repercussions on employment growth in the non-farm sector. West Bengal experienced poor bank credit growth accompanied by a reduced rate of growth in the number of enterprises as well as in the number of workers employed, during 1990-98. On the other hand, Tamil Nadu and Maharashtra, did relatively better in obtaining bank credit, and they were the only two major states to experience an improvement in the growth of rural non-farm enterprises, both in terms of numbers and total employment. (see Shetty, p.70)

The pattern of regional distribution of credit deteriorated along several dimensions simultaneously. An overall decline in credit-deposit ratio of scheduled commercial banks, as banks showed a preference for investments in risk-free government securities was accompanied by a much sharper decline in credit-deposit ratio in rural branches from over 64 percent to 40 percent over the past decade. This was about a third less than the RBI prescribed minimum credit-deposit ratio of 60 percent for rural and semi-urban branches. In a state-wise analysis of credit and deposit growth in the pre and post-reform period, Chavan finds that the historical imbalances in development of banking across states, which was consciously addressed by the development banking policy with a fair amount of success, re-emerged during the 1990s. Historically the intensity of banking was lower for the states from the northeastern, eastern and central regions. Under the policy of development banking, there were conscious attempts to correct this regional bias through aggressive expansion and improvement of rural banking infrastructure which was reflected in rise in proportion of credit advanced by the rural branches and proportion of credit allocated under priority sectors to these regions. During the 1990s, in a reversal of this trend, the states of Punjab and Maharashtra emerged as the major gainers in terms of the share of total rural credit advanced. Moreover, contrary to the growing importance of the Northern and Western region in the share of rural credit advances, there was growing importance of the Central and Eastern regions for mobilization of deposits by rural branches. Thus, a reverse flow of financial resources from backward states to the more developed states as well as from rural & semi-urban areas to urban and metropolitan centers became a leading feature of rural banking in the post-reform era. It is in this light that the interstate disparities in overall growth over the 1990s –with the poorer states experiencing slower growth compared to the more developed states of Western and Southern India, except Andhra Pradesh - can be seen. (Deaton and Dreze, 2002)

Patterns of Rural Indebtedness

The second part of the book takes the discussion beyond formal sector credit into an enquiry of rural credit markets, credit relations and patterns of indebtedness among rural households. This is done by means of five sets of detailed village studies that cover a range of socio political contexts and different stages of development of productive forces within capitalist agriculture. The primary surveys capture the specific *mechanisms* underlying the impact of changes in financial policy and banking structure on the marginalized sections among the rural households.

A trend uniformly emerging from the village studies is that of increasing *informalization* of rural credit markets in the 1990s. Evidence from Gokilapuram, a village in Tamil Nadu, resurveyed several times in the past three decades by Ramachandran and Swaminathan, shows that among the landless labour households in the village, the amount borrowed from the formal sector as a proportion of all borrowings was 17.4 percent in the `green revolution' phase (1969 to the late 1970s), rose steeply to 80 percent in the IRDP phase (1980s), and plummeted almost by 60 percentage points in the liberalization phase (1991 onwards). This is comparable to the Rural Labour Enquiry estimates (GOI, 2004) which puts the formal sector debt of agricultural labour households at 31 percent in 1999-2000 at the all-India level. In Gokilapuram, the vacuum created by the withdrawal of formal sector credit has been filled by an intensification of informal credit market activities. The village has witnessed a multiplication in the number of people who have taken to money-lending as their primary/ secondary source of income generation. Surpluses from commercial farming and from non-agricultural operations including salaried occupations have flowed into money lending. However, the greater supply of loanable funds notwithstanding, the personalized nature of transactions, and the heavy demand for credit have ensured that usurious interest rates continue to prevail. In fact, the findings from this paper indicate that the share of principal borrowed by landless labour households at rates of interest higher than 36 percent doubled between 1977 and 1999.

The study of Jharkhand villages (Ramachandran and Surjit) typifies the deplorable credit conditions in backward regions in the country. The region is characterised by underdeveloped state of rural infrastructure, lack of irrigation, low productivity and subsistence-oriented agriculture. Commercial banks are the only source of formal credit, and the flow of credit from this source to the two villages has been a very thin trickle. Only one household (out of more than 100 households) in each of the two villages received loan from the commercial banks in the year 2002 (the year preceding the survey). There aren't any cooperative credit institutions and the district level data indicates that the flow of credit from land development banks after having peaked in the 1980s fell to negligible levels thereafter. Moreover, one of the two villages with a predominantly Adivasi community lacks even informal credit sources as the moneylenders are unwilling to lend to such income-poor and asset-poor households. Given that credit is essential for consumption and cultivation by the households, and it is vital for medium and long-term land improvement and productive investments, the absence of credit market has served to reinforce the backwardness of the region.

In marked contrast to Jharkhand, Haryana received substantial government support due to the New Agricultural Strategy. As a result, the credit-deposit ratio in rural branches in Haryana have been significantly higher than the all-India level. However, Haryana without any major land redistribution initiative continued with a highly unequal agrarian structure, which had a direct bearing on the access to formal credit by different agrarian classes. In the two Haryana villages studied by Rawal and Mukherjee, a large number of households are landless labour households and have various kinds of short-term or long-term labour arrangements with the large landowners. One important reason why such labour contracts thrive is the possibility of obtaining credit by these landless households with otherwise limited access to formal credit. The authors find that `the dependence of manual worker households on their employers for credit, alongwith conditions of severe unemployment have forced these casual workers into unfree labour relationships, and in some cases into bondage.' (p.201) The labour arrangements observed here reflects a more general condition prevalent in many parts of India where such interlinked transactions becomes a means of surplus extraction by increasing the exploitative power of the stronger section. While there could be limits to exploitation in any one market, the interpenetration of the markets allows them to disperse exploitation over the different markets and to phase out exploitation over time as well. (Bharadwaj, 1974)

The case study of two West Bengal villages by Rawal are a corollary to the Haryana case. It highlights the ways in which land reforms and strengthening of local government institutions in West Bengal – the two major interventions of the Left front government - transformed the functioning of rural credit markets. Land reforms made a large number of marginal and small cultivators creditworthy. The involvement of panchayats in the process of lending and loan repayment led to better targeting of beneficiaries of bank loans and generally led to higher repayment rates on bank loan. These structural shifts combined with the macro-policy of social and development banking led to a substantial closing of the gap between West Bengal and India as a whole on several important banking indicators during the 1980s. In the post-reform phase as the growth of bank credit suffered, the intensification of informalization in the study villages is observed in the coming into prominence of a new class of suppliers of rural credit - the agricultural traders. In the two study villages, many large landowners and merchants have diversified into agricultural trade. These traders supply various agricultural inputs necessary for irrigated cultivation on credit with repayment tied to sale of the produce. While these interlinked transactions provide the stronger party with opportunities for surplus extraction through higher costs of inputs, under-pricing of produce, and by forcing the cultivators to settle the loan immediately after harvest when crop prices are low, Rawal draws a distinction between this new form of surplus extraction by merchant capital that is available for productive investment, and the traditional forms of surplus extraction by the landlord through rent and usury. Drawing on Patnaik's (1999) conceptual distinction between usurer capital and merchant capital, Rawal points out that while usurer capital is an obstacle to productive investment, merchant capital has actually financed and directed productive investment, at least in the short run. During the 1990s, it has helped finance operational expenses on cultivation when adequate supply of formal credit was not forthcoming.

The last case study of a Kerala village in the Malabar region by Ramakumar further underscores the strong relationship between *land reforms with the attendant transformation in agrarian structure* and the *nature of credit markets*. Kerala witnessed a ` remarkable expansion in the provision of credit to the poor from the formal sector, an expansion that was sustained even in the difficult years of financial liberalization in the 1990s.' (p.333) What made such an expansion possible? Firstly, distribution of homestead land to the landless labour households as part of the larger process of land redistribution in Kerala endowed these asset poor households with bankable collateral to participate in the formal credit market. Secondly, the cooperative movement, a direct offshoot of the struggle for land reform, laid a solid basis for expansion of cooperative credit societies with a true cooperative culture. As compared to the rest of India, cooperatives have accounted for a major share of formal sector loans along with the commercial banks in Kerala. The primary survey of the study village shows that in 2001, about 97 percent of the total principal borrowed by manual labour household involved in agricultural wage work came from the cooperative credit societies. Credit was extended at reasonable terms (both in respect to collateral and interest rate) to the borrower and unlike commercial banks, credit was not restricted to finance production-activities. In fact both Ramakumar and Rawal (the latter in the context of the study of one credit cooperative in West Bengal) go as far as to suggest that cooperative credit institutions have withstood, to some degree, the impact of financial liberalization on rural banking.

Is the cooperative banking sector truly in a position to counter the impact of financial liberalization on rural banking? Sen sounds a cautionary note in his analysis of rural cooperative banks at the all-India level. Disbursements from cooperative banks having grown significantly in the first half of the 1990s have thereafter tapered off. Besides the deflation in the farm sector in the late 1990s that affected the cooperatives adversely, Sen underlines the structural anomalies that continue to plague these institutions. Consider the interest rate issue. With liberalization of interest rates, commercial banks have reduced the loan rates, whereas cooperative societies often with high operational costs and heavy dependence on external sources of refinance have found it difficult to follow suit. Hardly 30 percent of these societies actively mobilize deposits, and on an average deposits comprise less than 25 percent of the working funds. The dependence on external refinancing compromises the loan portfolio of cooperatives in atleast two ways: (a) primary cooperative societies have to limit their loan portfolio to crop loans and cannot be flexible to the loan requirements of their members; and (b) external refinance automatically gives rise to the incentive problem in loan recovery. This is reflected in the situation where the commercial banks with massive deposits at their command contribute to reverse transfer of funds from the rural to metropolitan centers whereas cooperative credit institutions with a `well-defined base of rural loan demand are unable to offer attractive rates given their deposit performance.' (p.146)

Micro-Credit: Rhetoric and Reality

Official policy in India in the post-reform period looks increasingly to micro-credit as the major means of providing credit to the country's poor. Two papers in the present volume review the performance of micro-credit programmes in India. Contrary to the official claims of micro-credit programmes being an instrument for poverty-alleviation and gender-empowerment, what emerges is that these programmes have been no more than a tool to `externalize bankers' costs of lending to the poor and shifting these costs on to women participants and their households.

In a carefully designed primary survey of two villages in the drought-prone Telangana district of Andhra Pradesh, a state that accounts for over 50 percent of the self-help groups (SHGs) existing in the country, Rao finds that women from the lowest castes and classes are the least likely to join and remain in the self-help groups. From payment of the monthly amount necessary for participation to the ability to meet various administrative requirements for bank loan eligibility, women from the marginalized sections are less able to meet the costs of participation in the programme. Thus, the micro-credit programmes are largely reproducing the existing class and caste hierarchies. The survey also indicates that the SHGs are unable to disburse the kind of credit that could be used by members to generate sustainable long-run improvements in living standards. At the time of the survey, the SHGs had not received any bank loan and relied largely on lending to members from the groups' own corpus of savings. Such loans, repayable in 3-4 months, were used for consumption rather than for investment. Besides, the modal interest rate on micro-credit loans ranged between 24-36 percent per annum. Chavan and Ramakumar attribute this high rate to the practice of charging margins by each participant in the credit chain. When NABARD refinance to the banks at 7.5 percent, after being handed down from banks to NGOs to SHGs, finally reaches the members the interest cost is 24-36 percent per annum.

Why is there such a huge gap between the official pronouncements and the ground reality in the operation of these programmes?

The essential problem is in the design of the micro-credit programmes, Rao explains. While the design of the micro-credit programmes in India have made use of the notion of *group lending with joint liability* to ensure loan repayment by the borrowers, these programmes have ignored other important aspects of its design, namely, the staff-intensive and relatively costly methods of administering micro-credit groups. While the joint liability focus suggests that micro-credit groups will administer themselves, the experience on the field indicates that high repayment rates cannot be maintained without considerable administrative costs for the lender. `The success of micro-credit would then depend upon staff training and involvement in borrower activities, which are not very different from the requirements of `social and development banking programmes such as the IRDP.' (p.209) Rather, as Ramachandran and Swaminathan (2002) note, there is enough evidence to suggest that NGO-controlled micro-credit programme in India cannot match the reach and spread of banking system in India.[4] `Banks can cross subsidize loans, banks are better placed to provide specialized training to their employees in development banking; ...., and banks are better able to offer a wide range of financial services to borrowers.' (p. xxxv) Where then lies the case for micro-credit programmes?

A Valuable Contribution to Studies on Rural Credit

The volume `Financial Liberalization and Rural Credit in India' is a timely and important contribution to the body of research on rural credit issues, and would hence be of substantial value for researchers. For others who are interested in the debate, but lack formal economics training, this book is a good read for its simple style and a clear focus on providing a unified perspective on the rural credit problem based on thorough reasoning and a wide body of evidence.

The range of issues covered in the volume demonstrates the essentiality of research on the much-neglected area of rural credit and, at the same time, the substantial scope that exists for further research. Taking the cue from the primary surveys contained in the volume, I indicate one area for further research. In general, there is a dearth of in-depth studies of institutional credit sources such as the local branches of commercial banks/ regional rural banks, or the various tiers of cooperative credit institutions. As intermediary institutions that mediate official policies and form the crucial interface with local communities, these are important subjects of enquiry and must be studied in greater detail than what is reflected in the aggregate balance sheets of parent institutions. On the thrust area of financial liberalization and rural credit, primary surveys of FIs can be constructively used to understand the specific adjustment mechanisms undertaken by the FIs at the local level in response to specific policy shifts and the overall challenges of a competitive banking environment, given the socio-economic conditions prevailing in the region. The top-down and uniform financial policy approach ignoring sectoral, regional and functional differences lies behind much of the present decline in rural banking. One necessary step towards creating pressure for more nuanced policy that takes into account these wide ranging differences is to capture and mobilize the voices of the FIs. The view from below might indeed be different from the view from above. At this juncture, not only decentralization and autonomy in banking administration is necessary, decentralization of banking policy requires serious consideration.

Another practical use of field studies of institutional credit sources could be in checking the macro-trends in banking. Macro-data is known to be notoriously unreliable on certain aspects of banking. For instance, it is well-known that there is a considerable amount of adhocism involved in reporting priority sector lending by commercial banks and RRBs. Besides, there is no published information on certain sub-heads that fall under priority sector lending, like the number of accounts of small and marginal farmers with the RRBs.[5] Similarly, as Ramachandran and Swaminathan indicate, there is no published data on *actual*

[4] In Andhra Pradesh, bank credit to the SHGs in 2002 constituted a meager 0.6 percent of the total bank credit.
[5] See Estimates Committee (2002-3).

amount of credit disbursed by banks each year, that is, on the flow of credit. (pp.xxvi) Small sample estimates can provide useful information on such missing variables.

Finally, this volume based on rigorous research makes an impassioned case for restoration of development and social banking and to rethink the present policy of financial reforms. The value of this research would be greatly enhanced if it were to inform policymaking, and there are ample pointers to specific policy prescriptions in each of the chapters in the volume. Open debates on these issues, leading up to changes in policies where found warranted would be a logical conclusion of such policy research. Unfortunately, we know too well that dogmas have steadfastly prevailed over economic reasoning when they are backed by powerful interests, and there are dangerous portents of financial policy making in India being determined by such forces in the post-liberalization phase.

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