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Review by: Thomas A. Timberg
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Rural Credit in a Market Regime

Thomas A Timberg

Rural Credit Issues for the Nineties edited by Surjeet Singh; Oxford and IBH Co, Delhi, 1992.

THIS book contains the proceedings of a national seminar on rural credit sponsored by the Institute of Development Studies in Jaipur in August 1990 and attended by leading experts on issues affecting rural credit. The proceedings are fresh, accurate and stimulating, and reflect all the contradictions and difficulties, as well as the accomplishments, of the national rural credit system. The background papers, including a first-rate keynote address by R N Malhotra, are all quite interesting; nevertheless, one does wish that this volume contained more of the elements commonly found in a book. It includes an index, but has no bibliography or consolidated statistical appendix. It does, however, contain an excellent summary of the seminar discussion by Surjeet Singh.

Three of the contributors—C V Nair, Anil K Gupta, and G P Bhave—address general issues of rural credit, particularly the issues of sustainability and efficiency. B K Ghose, K V Patel, D Rajasekhar and Vinod Vyasulu focus on particular sub-topics or case studies. Ghose and Patel discuss the statistics on the proportion of the agricultural population covered by the credit system and Rajasekhar and Vyasulu report on a survey of bankers and borrowers in the Pali district that details the reasons for the various problems in the Indian rural credit system. The authors state that even in the drought-stricken Pali district wilful default turns out to be the predominant cause of overdues.

The book reflects the general contradictions in the Indian banking system, which have now reached a critical point. Two banking concepts are simultaneously present in India. At times banks are perceived as 'mobilising' savings and 'channelling' them to priority sectors to achieve productive efficiency and economic equity; at other times, banks are perceived as commercial service firms that provide financial services to productive firms: farms, industries, and trade in general. Both banks, as service firms, and farmers respond to market incentives. In no country does either concept dominate totally. Those with the most *laissez-faire* view accept, in John Gurley's words, that "banking is different". In return for a government-conceded monopoly of issue of check monies, banks have social responsibilities. They are so crucial that they cannot be permitted to fail as a whole. Consequently, some measure of prudential supervision and support is required. But the most *dirigiste* of countries cannot ignore commercial sustainability. In order to function banks must remain liquid. Inflation and government subsidy can keep banks liquid under any circumstances, but there are limits to how much inflation and subsidy can be tolerated. Consequently, banks must be sustainable, which means, among other things, that they must attract voluntary savings by paying competitive rates. Because the suppression of informal markets turns out to be difficult, banks have to compete with informal financial agents. To do so they must offer competitive rates, which are sometimes reasonably high. Banks must cover their operating expenses, meet their depositors' demands, and make new loans. In order to conduct these activities, banks need to have old loans repaid—to recycle monies.

The 1971 nationalisation of banks in India was sparked by a variety of motives, both political and economic, but there was a desire to channel savings for public purposes. The government of India is now even less able to sustain the levels of subsidy that would be required by the overdues than it was in 1971. Even then it was granted that the channelling of funds was constrained by the requirements of commercial sustainability. The consensus among the contributors to this book is that this nationalisation is no longer sustainable unless overdues are controlled, and that this control requires an element of political discipline that is not yet apparent. Individual episodes of loan forgiveness ordered by the government have exacerbated borrower's general predilection to default on loans. Bhave argues that certain areas of the country do not have the infrastructure or appropriate political leadership to permit banking.

The situation is not so different in many other countries, including India's neighbours. Pakistan, Bangladesh, and Sri Lanka all have largely nationalised banking systems, which have extended a considerable portion of their funds to priority sectors, such as agriculture, and to public sector firms. All of these banking systems face high arrearage rates that endanger the sustainability of their banking systems, and they are moving to confront this banking crisis through increased credit discipline, institutional strengthening and privatisation. They are also exacerbating their problems in what will seem very familiar ways to Indian observers; for example, Bangladesh has had several episodes of government-ordered loan forgiveness.

In India, there are also grave doubts, expressed in this seminar, about whether the current channelling of savings is achieving the productive efficiency and equity desired. Everyone wants to increase market-driven allocations of credit, have flexible interest rates, and the like, but everyone is also concerned with the allocation of credit to rural markets. Whether these market allocations are consistent with serving these rural markets is unclear. The expanding private sector banks in Bangladesh and elsewhere in South Asia have shown relatively little interest in rural lending. Informal markets continue to exist, but all indications point to a decline in the resources provided through them and by them primarily for working capital needs. Undoubtedly, a retreat of the public sector banks would lead to some revival of informal lending, but it is doubtful whether the informal market would make good the entire difference. Several alternative models for providing rural credit have been discussed, such as the one used by Philippine private banks and various onlending models being used in Sri Lanka and Indonesia, but experience with such models is still limited.

Regarding equity, Gupta and Bhave discuss alternative models for assisting the poor, such as the Grameen Bank in Bangladesh and the use of non-governmental organisations (NGOs) for greater effectiveness. Unfortunately, the focus is still 'top down'; that is, the focus is on how NGOs can help the banks. There is no question that NGOs can help banks, but their motivation is generally to help the borrower, and their relationship with the banks is instrumental only to that end. The success of the Grameen Bank is partly due to its institutional interest in a sustainable credit system—the challenge for Indian banks is to establish such an interest for the NGOs.

More generally, the weakness of Bangladesh banks and the government in serving the poor has resulted in the flowering of autonomous organisations and NGOs that undertake what might otherwise be banking and government functions. The number of these NGOs is large and their total volume of credit activity is several times that of the Grameen Bank. Clarence Maloney and A B Sharfuddin Ahmed present a now-dated account of these credit programmes in *Rural Savings and Credit in Bangladesh* (University Press of Bangladesh, Dhaka, 1988). The relative strength of Indian banks, and government and differential interest rates (DIR) in particular, is that they have limited the scope of NGO credit programmes in India. Groups such as the Self-Employed Women's Association (SEWA) and the Working Women's Forum (WWF) have been exceptions rather than the rule for NGOs in terms of the centrality of credit in their programmes.

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