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SOME MICRO OBSERVATIONS:
WHAT THEY REVEAL**

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INFORMAL CREDIT IN RURAL AREAS: SOME MICRO OBSERVATIONS: WHAT THEY REVEAL

I. INTRODUCTION

Working out ways to lift people out of poverty is a key objective within development economics. While there is a great deal of rhetoric on this subject, very little has been understood about what concrete steps can be taken. One policy area that has attracted a lot of theoretical attention is credit, access to which is often seen as critical in enabling people to transform their production and employment activities and to exit poverty. There is, however, a great deal of skepticism as to whether interventions in credit market are capable of reaching the poor. Rigorous interventions in credit market remain thin on the ground and, partly as a result of this, debates rage as regards whether interventions of various forms promote or undermine development. No where is the debate more heated than as regards formal credit. Here there are two opposing views: the first view, which has been dominant for much of the post-war period, states that expansion of formal lending institutions such as State sponsored commercial banks should be engines of structural change and poverty reduction in rural areas. A second view that does not dispute access to credit is critical to poverty reduction, however, views that government intervention in credit market is either ineffective or counterproductive and cannot canalize credit for the marginalized due to administrative impediments arising from multi agency system (the Central government, the State government, the Local government and the banks). Formal credit in rural areas will, therefore, tend to be captured by rural elites, and elite capture, combined with the imposition of interest rate ceilings can lead to financial dualism where formal concessional funds are concentrated in the hands of the powerful few and terms in informal markets. Thus expansion of subsidized formal credit can have the unintended consequence of undermining rural development and increasing rural poverty.

Of the total 1000 million population in India, approximately 720 million people live in rural India as per 2001 census. Of the total workforce in the country, 66

percent are in agriculture, which contributes about 27 percent of the GDP. This obviously explains why a large section of the rural people has low income. Though the percentage of rural population below poverty line in India continues to stagger at around 27 percent as per Planning Commission estimates (2000), alternative estimates based on NSS 55th Round put the figure to more than 90 percent.

The challenge before the Indian economy in the face of growing liberalization and free trade agreements world over is, therefore, to augment resources for sustained growth of the economy and reduce the disparity. This necessitates streamlining rural economy through diversification into non-farm activities, ensuring viability through competition and quality upgradation rather than protecting through subsidies and, at the same time, ensuring livelihood generation.

As the key to any development initiative through production system is finance, in India, the rural production system has been injected with subsidized finance through financial institutions. The end result of which has been a defaulting credit system, squeezing the viability and sustainability of the rural banking system. The whole idea of coessional credit to rural areas has been advocated with the objective of releasing the rural poor and marginalized from the clutches of usurious moneylenders comprising the large farmers, resource rich village traders etc.

II. TRANSACTION COST AND ASYMMETRY OF INFORMATION

It is well known that the spread of formal banking in rural areas has not succeeded in driving out the moneylender from the rural credit market (Mosley, 1996). Moneylenders continue to thrive essentially due to two reasons—one, because of the special kind of credit needs they respond to, which the formal sector does not and, second, because of the transaction cost advantages enjoyed by the moneylenders in comparison to those of the formal sector agencies like banks. While the basic philosophy in the policies of rural credit supply is replacing the money lenders essentially through subsidized credit, the entire approach proved to be counter productive in the sense that money lenders got an even better opportunity to expand their business base. According to transaction cost theory (Coase: 1960), institutions that evolve lower costs in the efficient allocation of resources are the key performers in the economy. These

costs include those of information, negotiation, monitoring, coordination and enforcement of contracts. When transaction costs are minimal or absent, initial assignment of property rights does not matter from the point of view of efficiency because rights can be mutually and voluntarily adjusted and exchanged to promote increased production. But when transaction costs are high, allocation of property rights is very critical.

In a closed area economy, the transaction costs are low but the production costs are high. The market is also limited and defined by more personalized exchange terms on credit basis. On the other hand, in a large network, interdependence increases so does the transaction cost, because all types of opportunistic behaviour arises in this type of dependence as the information gap widens. The asymmetry of information leads to a high transaction cost. The imperfect information theory has been used extensively in analyzing the growth of share cropping in land/labour market which emerged as substitutes for insurance against credit and market risk. Radical thinkers have often argued for abolition of the practice of sharecropping as it is believed to be the single most important factor responsible for emergence of marginal class and concentration of lands in few hands in rural areas. But mere abolition of the system without addressing the factors that led to its evolution will not do any good to the affected and the marginalized.

The sharecropping formula emerged as a cushion against risk of lending to the income poor in the rural areas. The illiterate rural marginalized or even the literate marginalized have small credit needs for farm activities which are of high cost if availed from the bank, given the number of visits etc. to the bank or formal institution. Hence the village money lenders, who are like ATMs, provide the much needed succor. However, the risk of lending to this group is equally perceived by the money lenders and, hence, sharecropping is the cushion against risk of lending.

The faster processing rate, better screening or enforcement devices (indicator: low rate of default) despite higher interest rate vis-à-vis the formal institutions, the informal sources of the village moneylenders no doubt are the only accessible sources for the poor and the marginalized for timely accessibility of credit. The better delinquency rates reported in respect of informal sources are largely due to better assessment of creditworthiness, ability to exert social pressure for repayment, and the frequent practice of tying credit to input or output contracts.

The credit contracts between the moneylenders (landlords or wholesale traders) and the borrowers are either tied in the form of input or output contracts. However, in the event of a higher risk factor of default, the lender involves mortgage of land holdings or gold ornaments or even livestock (milch cows). Therefore, it is obvious that money lenders are as much risk conscious as the formal agencies but the difference between the two systems lie in their procedural set-up which again is due to the operational and information differentials of the two.

It is a fact that rural borrowers are indifferent to the rate of interest. It is the timeliness in the availability of credit which is more important rather than the interest cost factor to the rural borrower. The reasons, why such contractual credit arrangements have been continuing in rural areas, can be looked at from two angles. The money lenders need these borrowers as much as the borrowers need the money lenders. While for the borrowers, the moneylenders provide ready and easily accessible sources of funds in times of urgent need, for the lenders they serve to build their reserve fund for expanding their business of lending. The differential rates of interest charged by the lenders from different borrowers are only to retain the clientele from switching over to other lenders. Thus higher the level of acquaintance (lower information asymmetry), lower is the rate of interest than the local market rate, which comes with a fairly longer period of repayment usually one year in the money lenders business cycle. However, at higher levels of information asymmetry i.e. lower level of acquaintance, the rate of interest is not only higher but also repayment period is lower, usually six months, tied with security (either collateral/livestock or tied loan) depending on the borrower class. The terms of loan contract vary with clients that the money lender deals with. An income poor, who acquires a low credit rating among the village money lenders, is at times financed by another lender from the next village at a much higher rate of interest with other contract measures that bind him to the money lender. Thus, often income poor borrowers are found to be creditors of money lenders from next village who then act as agents for the money lender to capture more income poor borrowers like him. This leads to the principal agent system in the business chain where the agent borrower than gets certain concessions on his loan and the money lender also ensures his client base.

However, conventional market theories clearly reveal that an effective market

matrix evolving out of this market game should place both on an optimum level of satisfaction. The argument in Indian financial market is that rural credit market is unprofitable and, poor are not bankable. If credit interventions for formal sources are unprofitable in rural areas, why the informal market thrives? It is relevant to ask what should be the right measure of success for rural credit. If it is poverty alleviation, the policies for rural credit need to look into the credit needs of households below poverty level. If it is creating employment, then the product market and the linkages to rural areas need to be studied before doling credit. If elimination of informal sources, like the money lenders, is the objective, then social conditioning has to be done before eradicating a system that has thrived for ages in the rural areas. Hence, demand component of the market needs a clear focus if effective credit policy is needed in rural areas.

Before arriving at a conclusive judgment whether state controlled banks are the appropriate conduit for rural credit, it is important to understand the nature of market demand for rural credit and the various buyers that comprise this market. The credit policy in India is supply driven and not demand driven. However, this is true of any product or service in India's rural context and credit is no exception. Hence, almost all the studies delving into the issues of rural credit have addressed it from the supply side while the demand side gets a passing reference.

The heterogeneity on the supply side of the lenders and demand side of the borrowers in Indian economy is an accepted phenomenon which, stems mainly from the high disparity level between the urban and the rural areas and, secondly, the disparity between the elites and the marginalized in the rural areas. Along with the formal regulated credit markets, the unregulated informal sector plays an equally important role in the financial intermediation. While the formal sector has a definite identifiable character in terms of regulations and its framework of operation, the unregulated and the informal sector have diverse character and no readily identifiable parameter to assess their intermediary role. Yet, the informal sector has a formidable presence in the rural credit market where they are the major suppliers of funds to the poor and the marginalized.

The core problem of rural finance as mentioned earlier is high transaction cost to the banks in financing a large number of small borrowers who require credit frequently and in small quantities. Besides, the high risk perception in financ-

ing small borrowers who are unable to offer physical collateral, articulate their case and submit proper loan proposals is yet another factor contributing to higher transaction cost. The social orientation for rural lending is another major cause which has sapped the formal agency in taking innovative strategies for rural lending. The rural areas are as much business worthy as the urban; the only difference lies in the asset base of the borrowers. Hence, credit products suitable for urban clientele if sold in the rural areas, are bound to default as much as social obligatory loans which include high subsidy component that kill the entrepreneurship and competitiveness of the rural borrowers.

The rural poor, therefore, perceive banks as alien institutions, which exist to serve the needs of "others". The physical and social distances constrain their approaches to bank branches which, for them, do not appear to be functioning with their needs in mind. Credit needs of the poor are determined in a complex socio-economic milieu where the dividing line between credit for 'consumption' and 'productive' purposes is rather blurred, making it difficult to adopt the traditional banking approach to lending. The result is that financial services of the formal banking system have remained inaccessible to majority of the rural poor and their reliance for credit is mainly on the informal credit channels. The borrowers, hence, face high transaction cost while dealing with banks due to distances, small value of loans, man days lost in commuting for a loan application, etc.

Informal channels operate outside the ambit of legal policy framework. Credit from the moneylenders and other informal sources is still rampant in most rural areas because it is usually available immediately, as and when required, and given away without any insistence on prior submission of land documents. The collateral security taken as cushions against high risk borrowers are collected by the lenders later but, the interesting point is that the borrowers too do not fail in honouring the commitment of such late submission mainly because they want to keep their channels of credit availability open.

The subsidized credit of the formal institutional sources tied to poverty alleviation programme of the government have created multi agency problem and problem of moral hazard in the rural credit market of India. (Choudhury: 2004). The rural credit programme has been supply driven rather than demand driven. Adverse selection of beneficiaries, political interference, financing of non viable activities have not only eroded banks credibility and business worthiness, it has also sapped the competitive spirit and entrepreneurial drive to fend for

ones own in the rural areas. The rural credit programme was thrown as if it were some *Pied piper of Hamilton*, who will deliver all the niceties. Even today, 28 percent of rural and 23 percent of urban families in India are still below poverty line. Though one do not find a wide difference between the urban and rural poverty, the rural urban discrepancy can be better understood when one delves in to the figures for average consumption expenditure per person per 30 days as reported in the NSS 58th Round figures. As per the NSS data, in rural areas the average consumption expenditure is reported to be Rs.531.49 while the corresponding figure is Rs.1011.97 for the urban areas. This clearly shows that urban average consumption expenditure is almost double that of the rural areas. Hence, one can easily understand the credit crunch of the rural borrowers. Further, the average land size possessed by a rural household in India is 0.84 hectares while 41.1 percent of the rural households possessed land sizes of 0.01-0.20 hectares as revealed by the NSS 55th Round. It emerges, therefore, that rural people are not only asset poor but also cash poor.

III. REVIEW OF SOME OBSERVATIONS ON RURAL CREDIT IN INDIA

Working out whether state led financial deepening is central to fighting poverty or whether it has been the victim of elite capture seems to be an important question for a number of reasons. Government control over banking was the norm in most low income countries in the four decades after the World War I, and subsidised bank credit continues to represent an important source of credit in rural areas.

Bardhan and Rudra's Study (1978) presents the results of an intensive and yet fairly large scale survey, of nearly 275 randomly chosen villages in West Bengal, Bihar and some of the eastern districts of Uttar Pradesh, made with the primary focus on the terms and conditions of land, labour and credit contracts. In a village economy, the terms and conditions of contracts in tenancy, wage-labour and credit transactions are sometimes inter-related, and the imperfections in the relevant factor markets get reinforced by such interlinkages. The study reveals that the landlord or the employer is an important source of credit to the tenant or wage labourer, but the evidence in Eastern India strongly suggests that incidence of 'usury' as the main mode of exploitation or, of bonded labour is very rare. The landlord quite often gives production loans to the tenant, shares in costs of seeds, fertilizers, etc., participates in decision taking about the use of this inputs and in general takes a lot of interest in productive

investment on the tenant farm. The landlords or employer also give consumption loans to the tenants and wage labourers, which are occasionally, interest free; sometimes interest is charged in the form of a wage cut for the casual labourer. But loans taken by the labourer, usually repaid in harvest time in grains and in labour, do not in general lead to long-term bondage relationships. The majority of the loans giving employers are self-cultivators using HYV seeds, chemical fertilizers, pumps and tube wells. Tenancy is on the decline and, self-cultivation, with the help of casual labourers and sometimes also attached labourers, is increasing.

The 1980s witnessed some disturbing trends in the rural credit delivery system with an alarming increase in the overdues in lending. The growth of overdues has been attributed to various factors. Rajasekhar and Vyasalu (1990) examined some of these factors in context of the rural credit delivery system in Pali district of Rajasthan. They found that the growth of overdues in the selected banks in Pali has been alarming. Most of the overdues are old and held by the willful defaulters. All categories/classes of farmers have defaulted. Most of the bankers tended to overstate their efforts at loan management. A deeper probe, however, reveals that the loan management is affected by such factors as inadequate field staff and transport. Thus, although many bankers state that they regularly undertake field visits and supervise the end use of a loan, such visits do not seem to have had much impact on recovery of loans. Structural problems, such as complicated procedures in the sanctioning of loans, and inadequate and untimely loans, also contribute to the problem of overdues. Moreover, the borrowers under the Govt. sponsored schemes are given inadequate (or no) guidance as far as production and marketing of produce is concerned. These factors resulted in misuse of loan and/or incapacitated the borrower to repay the loan. Political interference in identification of beneficiaries is yet another menace of the targeted rural credit programme. The priority sectors are more vulnerable to the problem of overdues because these sectors suffer from the problem of obsolete technology and low income generating capacity owing to poor market linkages of their products. Significantly, the authors found that the recovery percentages in Primary Agricultural Credit Societies (PACS) are better than those in commercial banks and RRBs as because it is an integral part of the community management without any external pressure.

D. Narayana (1992) examines the performance of the institutional credit programmes for rural development and, the attempts to improve poor loan

recoveries, especially the Group Lending Programme (GLP), and suggests that the problem lies with poor risk-management concepts. In India a multi-dimensional institutional lending structure has evolved over the last 100 years. Various institutional rural credit programmes have been undertaken from time to time. But there has been no systematic effort made at stabilizing agricultural incomes. A stabilization fund for co-operative credit came into being in the mid sixties. A guarantee for credit from commercial banks has also come into being. Though some thinking has gone into the issue of crop insurance since 1947, however, it came into being only in 1985 and has not been serving its purpose. In the absence of any systematic effort to stabilize incomes, the other way out of the cumulative loan default situation tried out in India has been the periodical writing off of loan overdues. But this has vitiated the whole atmosphere for recovery of dues and has brought in an element of willful default. In the face of mounting overdues, vitiated recovery atmosphere and the consequent poor health of the institutional credit structure, the attempt being made now is to try out the GLP. But, the experience of Thailand or Zimbabwe clearly shows that GLP can have only limited application. In order to achieve a good recovery performance, the size of the groups of GLP has to be small. But for proper risk management through insurance, the size has to be large. Hence, a balance has to be struck between the two.

Shivamaggi (1993) found that credit for the rural sector is no longer merely financing of agriculture. It is now rural development credit encompassing of all farm and non-farm economic activities in the rural areas. The objective of rural credit policy in India is to institutionalize rural credit. With the lead given by the RBI, up till now, many review committees and study groups have examined the rural credit problem from time to time and recommended a series of remedial measures. But still the problem remains, partly on account of the peculiarities of socio-economic conditions and political environment and partly due to lack of serious efforts to implement the various recommendations made as a package. Proliferation of rural credit institutions resulting in costly and wasteful system, inadequacy of staff compared with the volume of lending operations under mass loaning programmes and lack of staff motivation, resulting in poor quality of loaning, undue emphasis on credit while neglecting equally important non-credit supporting services essential for successful rural lending, political and vested interest pressures resulting in poor quality of lending and mounting overdues, and lower lending rates leading to financial weakness and danger of loss to the institutions.

The current wave of marketisation and privatization in the financial sector has resulted in the marginalization of issues relating to rural credit in many developing countries, particularly those under the tutelage of the IMF and the World Bank. A mechanistic application of market theology to rural finance has ended up in withdrawal of Government/Central Bank support to the rural credit mechanism and in the element of concessionality in the interest rate structure. All this is indeed welfare decreasing.

Majumdar (1994) in his article argues that the package of standardized and simplistic prescriptions for financial sector reforms stand as a monument of misplaced priorities in many developing countries. The most conspicuous example of misplaced priorities in terms of financial sector reforms is the nearly total neglect of rural credit, in sharp contrast to the extravagant emphasis placed on the development of capital and money markets. The reform faddism has cut at the roots of the rural credit structure by withdrawing Government/Central Bank support and the concessionary lending rates. In many developing countries, macro economic compulsions demand that employment should rapidly increase if a significant dent on poverty is to be made. The organized sector is incapable of providing such a massive expansion in employment. One has, therefore, to look into agriculture and allied activities, the non-farm sub sector, rural industries, including agro-exports, small, tiny and service sub-sectors, market related self-employment programmes and so on, for immediate gains in employment and GDP. The salvation of developing economies lies in the revitalization of the rural economy and the small and tiny sectors; and in this process of revitalization, credit can play a catalytic role. Multilateral institutions, like the IMF and the World Bank, appear to be impervious to the macro economic compulsions of the developing countries and, hence, the package of standardized and simplistic prescriptions for financial sector reforms betrays an innocence of the ground realities. Therefore, evolving an appropriate credit delivery system to reach and support the rural economy/priority sectors should occupy a pre-eminent position on the agenda for financial sector reforms, notwithstanding the proclivities of World Bank/IMF. In fact, evolving a new credit regime is important because conventional bankers are neither good at nor interested in exploring investment opportunities in the rural sectors. If institutional credit is to reach and support the rural sectors, a new credit delivery system involving ease of access, simplifying procedures and practices of lending and repayment, and a whole range of advisory services would have to

underemployment will continue to haunt the economy on an alarming scale and, hence, directed credit and concessional lending should continue to form an important ingredient of macro economic financial policy.

Satish and Gopalakrishnan (1997) while reviewing the framework regarding viability of banking, examines the macro-level components of the financial structure of rural banking institutions, and, whether non-viability is structurally in-built. The authors argue that there is nothing intrinsically non-viable about rural banking operations or rural financial institutions as such. The analysis views the impact of one sided intervention in rural financial markets which can have a series of unfavorable consequences like poor distributions of loans, low repayment discipline and, political interference to be responsible for the non-viability of the rural banking structure.

Agrawal, Puhazhendhi and Satyasai, (1997) reviewed the rural credit structure, performance and problems keeping in view of the challenges posed by the latest developments in agriculture and the economy. Despite conscious efforts for the expansion of credit to agriculture, there exists a substantial gap between the demand for and supply of agricultural credit. The dependence of small farmers and less developed regions in the country on informal sources for credit is still quite high, though there has been substantial increase in demand for agricultural credit in India in view of the commercialization and diversification that has taken place in the sector over time. However, much remains to be done. The task before the rural credit system in the 21st century would be formidable and complex as it has to deal with two diverse challenges, namely, addressing to the basic problems of rural development and globalizing Indian agriculture. Thus, it has to deal with two distinct clientele groups; the first group comprising those who have small individual credit needs but account for high proportion of total credit needs and, the other group comprising those who are engaged in capital-intensive, export-oriented hi-tech agriculture and their bulk requirements are high. Hence, what is needed is to gear the existing credit system to these challenges. Though some measures have been undertaken to revamp the rural credit system, including execution of Memorandum of Understanding (MOU) by NABARD with co-operative banks and RRBs based on Development Action Plans (DAPs) with a view to improving their viability and performance however increasing the outreach of credit and maintaining the viability standard of the institutions must be the priority for strengthening the existing credit delivery mechanism. Re-focusing on the priority sector lending will provide for higher share of credit to rural poor

Majumdar (1997) argues that financial sector reforms, introduced during the period 1991-96, have seriously eroded the flow of resources for financing rural development, including agricultural development. Fortunately, the United Front Government's first budget in July 1996 took a number of initiatives in the area of rural credit. These marked a clear departure from the *Washington Model* and brought rural credit bank into the mainstream of financial sector reforms. While these are welcome, they don't address the basic question of viability of the rural credit delivery system. The twin problems of high transaction costs and poor repayment performance would need to be tackled first, if a vibrant credit delivery system specifically designed to meet the development imperatives is to be evolved. In this exercise of evolution, the *Washington* or the *Basle* models are not of much help. Indigenouslyness has to be the fulcrum of innovative approaches in this area. Linking Self Help Groups (SHGs) and Voluntary Organisations (VOs) is one such innovative modality, which seems to merit serious consideration. Such linkages have helped reduce transaction costs and also ensured decidedly better repayment performance. NABARD's 'Linkage Programme of SHGs with Banks' has proved to be a successful model, though on a modest scale. Investigations have shown that the intermediation of VOs and SHGs helped banks to reduce the transaction costs by some 20 to 40 percent, as compared to direct lending. Similarly, such intermediation also proved useful in improving recovery rates. The intermediation also reduced the transaction costs of the borrowers by about 85 percent. Though the experiment was on a modest scale, it is certainly replicable. The autonomous growth of SHGs or VOs may, however, take a very long time and it makes little sense to wait for such growth to blossom by itself. A scheme for actively promoting such participatory institutions on a nationwide scale, therefore, needs to be worked out. Only such a mass movement can bring about a structural transformation in the rural credit delivery system and would enable the system to meet the development challenges. Development imperatives demand that overhauling of the somnolent rural credit delivery system should form an integral part of any meaningful package of financial sector reforms.

In analyzing the performance of the rural credit delivery system in three focus areas of the rural credit markets, viz., agricultural, non-farm sector activities and poverty alleviation and, the challenges that the banks are likely to encounter in the next decade, Puhazhendhi and Jayaraman (1999) acknowledges that credit delivery system in the country has metamorphosed from monopoly of co-operatives with the induction of commercial banks and establishment of

regional rural banks for improving the outreach and ensuring access to credit in rural areas. With the implementation of financial sector reforms, the accent is on ensuring the financial health of the system. Innovations in rural credit delivery had an impact on agricultural production and reduction of poverty due to increased flow of credit. Credit acts as a facilitator and it performs the important function of providing the farmers with the requisite control over resources affecting production, and, there has been a significant and positive impact on the gross value of output in agriculture. The increased flow of term credit has contributed to the growth of capital formation in the private sector in agriculture.

Over the years, the promotion of rural non-farm sector (RNFS) has been encouraged for providing alternative sources of employment and income generation in rural areas in lieu of agriculture. The analysis of the data on credit limit to the RNFS by the commercial banks showed that although flow of credit has increased during 1973-1995 in absolute terms, the proportion of number of accounts, credit limits sanctioned and amount outstanding as percent to the bank credit did not show any remarkable change. Credit extended to rural industries has not been sufficient to their growing requirements. The refinance facility by the NABARD has to an extent eased the situation. Poverty reduction through gainful employment or by way of asset creation supported by credit for raising the income levels of the poor had been the cornerstone of the IRDP programme, implemented throughout the country since 1982. Despite criticisms and difference of opinion on efficiency in its implementation, there are no two opinions on the programme's success, albeit limited, in reducing poverty in India. Despite the massive subsidy-credit linked programme under IRDP, poverty levels in India continue to be high (UNDP-1997) and many people still do not have access to formal credit institutions. As an alternate strategy, SHG-NGO-Bank model was introduced. With a view to evolving supplementary credit strategies for reaching the unreached rural poor, NABARD had in 1992-93 introduced the Pilot Project for linking self-help groups (SHGs) with banks and, the project has shown remarkable progress over the years. Hence, new credit initiatives have to address the needs of non-farm sector in order to ensure rural employment and releasing the disguised labour force from the agriculture, if India wishes to reduce its poverty level effectively.

Satyasai and Badatya (2000) argues that rural credit co-operative institutions (RCCIs) set up in India over the years, has become quite complex and, hence, there is a necessity for

tionalization of commercial banks in 1969, co-operatives were the only channel through which demand for rural credit was met. Over the years, following the recommendations of various committees set up to review the working of the credit system from time to time, a huge cooperative structure has been built. As a result, RCCIs have emerged as one of the key players in the field of rural credit. An analysis of the functioning of the RCCIs reveals that the co-operative system in general failed to perform its functions, a few success stories here and there notwithstanding. Many a committee has gone into the question on non-viability of RCCIs and suggested ways to revamp the co-operatives. Needless to say, the problems of RCCIs got accentuated on account of certain weaknesses- some internal and others external, such as depletion of resource base, declining business level, rising transaction costs, mounting overdues, erosion in leadership, defective management, excessive bureaucratization and official domination, etc. Hence, delivery has to be restructured in order to provide effective service to the borrower at minimum cost. Cost reduction per unit of business can be achieved by rationalizing the co-operative structure by way of integration of short-term and long-term wings, and removing one of the tiers, and, exploiting scope and scale economies available in rural lending. The limitations of co-operative system such as inability to offer all types of financial services that commercial banks/RRBs offer, such as money transfer through drafts / MT, etc., restricted area of operation and activities, inability to cater to credit needs for all purposes from a single outlet, low level of professionalism etc., have to be overcome. Real success comes when co-operatives take full advantage of their ability to have close interface with the clientele. This ability almost matches similar ability of non-institutional rural lenders and, can, never possibly be acquired by other institutional agencies.

In most of the studies systematic attempts have been made to identify the problems of institutional credit delivery in the rural areas, but the simple issue on the credit needs, frequency and the size variation with respect to income is however glossed over. Perhaps it is more immediate now to understand this differential rather than reevaluate the system over and again bypassing the crucial issue of demand size of the credit and the buyers' class.

The present study is an attempt from demand side of the credit market. It is a micro level study which endeavours to understand the credit needs of income poor people and its diverse nature. The study has also addressed some issues of informal lenders.

IV. DEMAND FOR CREDIT IN RURAL AREAS

There are three segments of demand for rural credit (Mahajan: 1997). At the base are the asset poor and asset less rural landless households who are either engaged as seasonal labourers in agriculture, mining, quarrying and the casual workers. The basic credit requirement of this section is for consumption purpose during days of no-work and for other contingencies like sickness, social obligations like marriage etc. However, there is also demand for production credit from this group which essentially caters to the requirements for acquiring small productive assets, such as livestock, through which additional income can be generated.

The second group comprises the small and marginal farmers, rural artisans, weavers and petty traders. The main credit requirement for this group is for working capital (production credit). However, there is requirement for consumption credit also though the size and frequency is comparatively smaller than the earlier group. The demand for consumption credit is essentially for meeting expenses on social obligations and functions.

The third group comprises small and medium farmers and also small salaried job holders. However, while the credit requirement of the farmer class is for production purpose, the salaried small job holders require credit for consumption requirement mostly in terms of acquiring some consumer durable assets or any social obligatory expenses.

It may be noted here that among the three groups, the medium farmers from the third group have been able to access the formal banking institutions for obtaining credit. However, the credit so obtained is purely for production purpose in respect of his farming uses.

Therefore, a major demand component for credit in rural areas which is for consumption purpose is, however, not available for these groups of people from the formal institutional sources.

V. RURAL CREDIT USAGE BY PURPOSE, TERM AND SOURCE

In a study of World Bank by Price Waterhouse during the period 1994-96, an estimate was made of the average annual credit usage by rural households in

India which worked out to be Rs.14,549. Of this, 65 percent was for productive purpose, of which, 16 percent was for long-term productive purpose and the remaining 49 percent for short-term working loan assistance. The total consumption credit usage was 35 percent, of which, 15 percent was on account of long-term purpose like house building, marriage etc. and 20 percent for short-term expenses like clothing, consumer durables etc. At lower end of the income class, more credit was used for consumption purpose while, at the higher end of the income class, credit usage was for income diversification.

It needs to be mentioned that demand for credit is not synonymous with credit usage since supply constricts it. In 1999-2000, Agricultural Credit Review Committee under the Chairmanship of Prof. Khusro estimated that the demand for credit in rural areas is Rs.144,400 crores, of which, the short term component is Rs.53,534 crores and the medium and long term component is Rs.57,339 crores for the agriculture sector, and, Rs.30,752 crores short term and Rs.2,775 crores long term credit in agro-processing, marketing and export sectors.

The demand for short term credit is higher in rural areas since fast cash is needed in all transactions and, liquidity preference of rural households for transaction motive suffers from liquid cash due to low income.

VI. SUPPLY OF RURAL CREDIT

Of the total credit supplied by banks as per the latest RBI statistics, only 9.7 percent is for the rural areas in India. This clearly shows that the accessibility of the rural poor is severely restricted in so far as bank credit is concerned. The World Bank Study (1997) revealed that of the total credit usage, the formal sources supplied 22 percent while non-formal sources supplied 78 percent of the credit requirements.

However, as per the NSS 42nd Round, in 1991, though almost 64 percent of the total credit supply was from the formal sources, (of which, banks comprised 34 percent) and 36 percent from non formal sources, it needs to be accepted that in case of asset group of less than Rs.5000, the dependency on the informal sources was as high as 58 percent while, 19 percent in the highest asset group of Rs 25 lakh and above, availed credit from informal sources.

Thus, ameliorating poverty through credit programme proves to be highly distorted in the rural areas. In fact, the NSS 55th Round data shows that a major component of rural income is from wages/salary, rent, pension and remittances which indicates that rural households prefer a steady flow of regular wage income compared to entrepreneurial business risks due to various impediments in the production market. Hence, to tackle the problem of poverty in India, it is necessary to diversify the livelihood options with wage income for the asset poor and income poor rather than dole cheap concessional credit for business enterprises.

VII. WHY THE GAP?

India's rural financial system has been oriented towards meeting the physical or financial targets, based mainly on past developments. The efficiency and viability of schemes financed are overlooked in the over ambitious plan of concessional lending. The adverse selection coupled with political nepotism, often overlooks the credibility and sustainability of the schemes developed and implemented. Achievement of statistical targets has become the hall mark of the programme rather than qualitative improvement in the rural livelihood pattern. The end result has been pilferage at all levels, the biggest beneficiary of which has been a handful of resource rich in the villages, who built their coffers to run a thriving informal lending business at the expense of marginal class for whom these loan schemes were designed, leading to further impoverishment of the impoverished.

VIII. RURAL CREDIT MARKET: SOME EVIDENCES FROM BACKWARD AREAS IN ASSAM

The low credit absorption in backward areas like eastern UP, Bihar, Orissa and the Northeast region have led to low CD ratio for the commercial banks. In fact, in Northeast region, the commercial banks are the only financial intermediaries and, their poor outreach in terms of credit deployment has led to outflow of deposits collected in the region to other regions. Among the Northeast states, Assam has the largest network of bank branches. In fact, of the total rural bank branches in the region, 64 percent is located in rural Assam. These branches account for 68 percent of the rural credit in the region. Despite this impressive figure, rural areas in Assam have failed to expand credit outreach and, vast majority have remained outside the bank credit facilities despite their

credit worthiness. This can be inferred from the fact that while rural Assam accounts for 3.13 percent of the total rural population of the country, it has only 2.47 percent of the rural bank branches. Thus, a rural bank branch in Assam serves an estimated 29,466 persons against the national average of 23,198 persons or, in other words, the number of rural households served by a rural bank branch in Assam is 5328*. On the other hand, the rural staffing pattern in the branches reveals that on an average a rural branch has one manager, a clerk and an attendant. Thus, the average employee strength in a rural branch is three and of these two persons are to handle the loan and deposit portfolio for at least 10656 (= 5328 x 2) accounts, if only one deposit account and one loan account is assumed per household. This clearly shows that rural branches have reasons to shy away from deploying credit in rural areas and concentrate on deposit mobilization.

The picture is even worse off in backward districts of the State where creditworthiness of the borrowers is assumed to be low because of low income and high poverty levels. Among the districts in the State, Dhubri is worse off. It is not only ranked lowest in terms of HDI, education index and health index, it also ranks third from bottom in terms of poverty index and, seventh from bottom in respect of income index among all the districts in the State. The CD ratio in the district is 25 percent, much below the State average, of 32 percent as per the RBI data (June, 2005).

This obviously raises queries on the sources of informal finance for economic activities of the rural poor in the district and their style and pattern of functioning. The study aims to capture the functioning of the informal sector and the demand pattern of credit of the rural households in the Fekamari Development block in the district, to get insights into informal credit market in backward areas of the State.

IX. REVELATIONS FROM A MICRO SURVEY

> BACKGROUND OF THE STUDY AREA (DHUBRI DISTRICT)

As mentioned earlier, among all the districts of Assam, Dhubri district, situated on the southern bank of Assam, is the most backward. The district comprises 14 blocks, of which, Fekamari development Block is the most underdevel-

oped. Hence, the study purposively selected this block in order to understand the credit market in the rural villages of the block.

The district, with a total geographical area of 2838 sq. kms, is located in the extreme south-western corner of the state of Assam. The district is bounded by Kokrajhar district in the north, Bongaigaon & Goalpara districts in the east, Meghalaya & Bangladesh in the south and, West Bengal & Bangladesh in the west. The district consists of 3 Sub-Divisions, 14 Development blocks, 14 Anchalik Panchayats, 172 Gaon Panchayats, 7 basic Towns and 1,284 inhabited villages. The river Brahmaputra flows through this district from east to west with its tributaries like Champabati, Gaurang, Tipkai, Sankosh, Jinjiram, etc.

Total population of the district as per 2001 census is 16,34,589, of which, 8,40,673 (51%) are male and 7,93,916 (49%) are female, and, the sex ratio is 944 females per 1000 males. 88.38 percent of the people in the district live in rural areas and the remaining 11.62 percent lives in semi-urban areas. The district has the highest population density (584 persons per sq. km) in the State. The district ranks lowest in terms of literacy compared with other districts of the State. As per 2001 census, the literacy rate of the district is 49.86 percent with male literacy of 61.90 percent and female literacy of 42.64 percent. The HDI (0.214), Education Index (0.454), and IMR Index (0.086) of the district are the lowest in the State while the Human Poverty Index (HPI) in the District is third highest in the State at 31.98 as shown in table-1.

Table 1: Human Development Indices of Dhubri district

Items	Year	Value/Rank
HDI	2003	0.214 (23)
Education Index	2003	0.454 (23)
IMR Index	2003	0.086 (23)
Income Index	2003	0.102 (17)
GDI	2003	0.206 (21)
HPI (A)	1999	31.98 (21)
HPI (B)	1999	41.92 (20)

Note: Figures in brackets indicate Ranks among the Districts of the State
Source: Assam Human Development Report (AHDR) 2003

As per the AHDR (2003), Dhubri ranks 14th among the districts in the State in terms of Per Capita DDP of Rs.1435 in 1994-95 (at 1980-81 prices). The District contributes 5.12 percent of SGDP. The share of the District in SGDP is given in the table below:

Table 2: Sector wise Contribution to SGDP

Sectors	% share in SGDP at Current Prices (1994-95)
Primary Sector	5.31
Secondary Sector	5.57
Tertiary Sector	4.65
All Sectors	5.12

Source: AHDR (2003)

The sectoral contribution of Gross DDP is shown below; where it is found that the primary sector contributes the major income share in GDDP.

Table 3: Sector wise Contribution to GDDP

Sectors	% share in GDDP, 1994-95 (at 1980-81 prices)
Primary Sector	43.02
Secondary Sector	14.89
Tertiary Sector	42.09

Source: AHDR (2003)

The District is primarily dependent on agriculture, viz. paddy cultivation. Jute and mustered seed occupy the major share of cash crops. Fish, milk, meat and egg production have small contribution to the economy. Some amount of handi-craft industries are also found in the district with rural artisans engaged in making items from jute, bamboo, pith craft, terrakotta etc.

The banking infrastructure of the district comprises 12 branches of State Bank of India, 12 branches of United Commercial Bank, 5 branches of United Bank of India, 11 branches of Pragjyotish Gaonlia Bank, 2 branches of Assam Co-operative Apex Bank and, 6 Branches of other banks as per the RBI statistics (December 2004). The population coverage per branch of bank offices in the district is 34,054 which clearly shows that the population coverage per bank

➤ FEKAMARI DEVELOPMENT BLOCK

Among the fourteen development blocks in the district, the Fekamari Development block is the most backward. The Block, with its Head Quarter at Fekamari, is located at the middle part of the South Salmara-Mankachar Sub-Division. It has an area of 96.47 sq. kms.

The Block is bounded by South Salmara Development block in the north, West Garo Hills district of Meghalaya in the east, Mankachar Development block in the south and Bangladesh in the west. The block consists of 14 Gaon Panchayats (GP), of which Sukchar, Molakhowa Barairalga and Kanaimara are river eroded and the people of these GPs are economically very poor. It is worth mentioning that the only connectivity of this block with rest of the State is provided by the NEC road running through Meghalaya. The Civil Sub-Division of South Salmara-Mankachar is located at Hatsingimari within this block area, which is 3 km away from the block head quarter. The District head quarter Dhubri is situated on the northern bank of the River Brahmaputra while the block headquarter is on the southern bank.

The total population of the block as per 2001 census is 101,747, of which, 51% (51,891 persons) are male and 49 % (49,856 persons) are females. The sex ratio for the block stands at 961 females per 1000 male. About 5 percent of the total population is Hindu and the rest are Muslims by religion. The literacy rate of the block is only 23 percent as per 2001 census.

The economy is underdeveloped and agrarian in character with over 98 percent of the total population living in the rural areas, and, more than 90% engaged in agriculture for their livelihood. Most of the rural people live below the poverty line. There is a weekly market held every Sunday at Hatsingimari under this block, which is the major source of supply of necessities to the people of the block as well as for people from the nearby state of Meghalaya (West Garo Hills district: Tura, Garobada, Rajabala etc).

The block has three bank branches, one each of State Bank of India, United Bank of India and Pragjyotish Gaonlia Bank. However, due to some conflict between the local people and the bankers, the United Bank of India branch has been shifted to the district headquarter and has been operating from there. Thus, the block virtually has two operating branches. The population cover-

age of the two bank branches work out to be 50, 874 persons per branch. The staff strength in the two bank branches are 5 and per bank person coverage in the block works out to be 4796. It is, therefore, obvious that such shortage of manpower cannot effectively address the issue of credit deployment in the block with 77 percent illiterate persons. The transaction costs will be high for both supply side formal agents as well as for the illiterate borrowers. When transaction cost is high, formal supply is obviously constrained, the informal sources as a corollary plug in as demand for credit is high. The rural people have no alternative but to approach the money lenders. The following business volumes of the two bank branches will further clarify the point.

1. PRAGJYOTISH GAONLIA BANK, KHARUABANDHA BRANCH (Figures up to March 31, 2005)	
Total Deposits	Rs. 2,26,03,000.
Total Credit	Rs. 2,03,00,000.
C-D Ratio	89.81%
Total NPA	Rs. 97,00,000.
2. STATE BANK OF INDIA, HATSINGIMARI BRANCH (Figures up to May 31, 2005)	
Total Deposits	Rs. 3,67,03,000.
Total Credit	Rs. 2,83,61,00
of which	
✓ Bank finance	Rs. 28,68,000 (10%).
✓ Govt. Sponsored	Rs. 16,3,18,000 (58%).
✓ PMRY	Rs. 91,75,000 (32%).
C-D Ratio	77.27%
Total NPA	Rs. 1,36,68,000 of which Agriculture (82%), PMRY (98%).

Source: PGB, Kharuabandha Branch,
SBI, Hatsingimari Branch.

The figures from the SBI clearly reveal that while the bank has financed only 10 percent under its own scheme the rest of the financing has been under the various govt. programmes. Again bulk of these loans under the govt. programmes has become NPAs which points to the non viability of the govt.

schemes, due to the poor market linkage which is due to the poor connectivity, as well as lack of entrepreneurial dynamism due to poor literacy.

❖ OBSERVATIONS FROM THE SAMPLE STUDY

The observations of the sample study has been derived from 40 borrower households and 10 lender households selected at random from six Census villages viz. Fulerchar, Hatsingimari, Bamuneralga, Kokradanga, Sukchar and Tangnamari. These villages have been purposively selected based on two criteria: the first criterion is that the informal lending is comparatively more prominent in these six villages of Fekamari block and the second criterion is that these villages are along the Bangladesh border. Moreover, since the Study also aimed to find any evidences of cross border lending the sample survey has been conducted in these villages. The data has been collected through structured questionnaire and field discussion. The data from the sample survey has been analysed using the SPSS package. The Study has looked into the demand size of credit and the impact of interest on the borrower households and does not aim to establish any claim on the merits and superiority of informal or formal credit supply in response to demand. It only aims to bring out some of the micro details in the demand and supply of rural credit.

Table 4: Distribution of the Borrowers and Lenders w.r.to Villages

Village	Borrower (nos.)	Lender (nos.)	Total(nos.)
Fulerchar	12	3	15
Hatsingimari	7	2	9
Bamuneralga	4	1	5
Kokradanga	7	2	9
Sukchar	8	2	10
Tangnamari	2	0	2
Total	40	10	50

Source: Field Survey 2004

❖ DEMAND FOR CREDIT

The demand for credit of the sample borrowers is divided into two groups, viz. production credit and consumption credit, depending on its end use. Further, the demand varies with size class of income. These are illustrated in the following tables (table-5 to table-10)

Table 5: Distribution of Borrowers w.r.t Main Occupation

Occupation	Nos.
Agriculture	15
i) Subsistence	6
ii) Commercial	9
Non-Agriculture	25
i) Wholesale Trade	0
ii) Retail Trade	9
iii) Petty Business	8
iv) Salaried Service	3
v) Wage Labourer	3
vi) Others	2
Total	40

Source: Field Survey, 2004

Table 6: Distribution of Borrowers w.r.to Income and Expenditure

Annual Expenditure (Rs.)	Annual income (Rs.)						Total
	10000-30000	30001-50000	50001-70000	70001-90000	90001-110000		
< 10000	1	0	0	0	0	1	
10001-25000	4	0	0	0	0	4	
25001-40000	4	18	0	0	0	22	
40001-55000	0	3	4	0	0	7	
55001-70000	0	0	1	1	0	2	
70001-85000	0	0	0	2	0	2	
85001 & above	0	0	0	0	2	2	
Total	9	21	5	3	2	40	

Source: Field Survey, 2004

Table 7: Distribution of Borrowers w.r.t Sources of Borrowing

Sources of borrowing	Nos.
Only FI/Bank	3
Only SHG	1
Only Money Lenders	27
Only Relatives	1
Bank+ Money Lenders	4
Money Lender+Friend	3
Money Lender+Relative	1
Total	40

Source: Field Survey, 2004

Table 8: Distribution of Borrowers w.r.to Term and Purpose of Borrowing

Term	Purpose		
	Production	Consumption	Total
Medium-Term	5(14%)	0	5
Short-Term	32(86%)	8(100%)	40(89%)
Total	37	8	45*
Total Amt. (in Rs.)	565000	101000	666000
Average Loan Size (in Rs.)	14145	12625	13875

* 5 households have borrowed for both consumption & production purposes.

Source: Field Survey, 2004

Table 9: Distribution of Borrowers w.r.to Income Category and Purpose of Borrowing

Income Category (in Rupees)	Production loan	Consumption loan	Both Consumption & Production	Total
10000 - 30000	8	1	0	9
30001 - 50000	18	1	2	21
50001 - 70000	5	0	0	5
70001 - 90000	1	0	2	3
90001 - 110000	0	1	1	2
Total	32 (80%)	3 (7.5%)	5 (12.5%)	40 (100%)

Source: Field Survey, 2004

The use of credit as seen from the sample is concentrated in the annual income class of Rs. 30001 – Rs. 50000 (table-9). At higher income level the demand for credit is low. This shows that at higher income level, people prefer to manage with their own income level. Further, only seven households have approached bank for production credit which shows that banking habits are yet to develop.

Table 10: Distribution of the Borrowers w.r.to Amount of Loan as Percentage of Income

Amount of Loan As Percentage of Total Income	No. of Borrowers
1-20%	8 (20%)
20-40%	22 (55%)
40-60%	9 (22.5%)
180-200%	1 (2.5%)
Total	40 (100%)

Source: Field Survey, 2004

Moreover, the average monthly income of the borrower households is found to be around Rs. 3800/- There are number of households whose average monthly income is less than the sample average. An estimate of the income-loan ratio (table-10) shows that for more than 50 percent households, the ratio works out to be 20% to less than 40%; while for 22.5 percent of borrower households, the ratio stands at 40 % to 60%. This reflects the liquidity crunch in income poor families. The absence of savings forces people to borrow for transaction motive from the readily available sources like money lenders.

❖ ESTIMATION OF DEMAND

An estimation of the aggregate credit demand for Fekamari development block can be obtained from the above data. If the annual average credit needs per household in the block is estimated to be Rs. 13,857, based on sample survey, then the total credit demand for the block comes to Rs. 33.3 crores.

However, the data from the two banks in the block viz. Pragjyotish Gaonlia Bank and the State bank of India indicate that the total credit off take has been on Rs.7,20,29,000 including the NPA as on March 2005.

This in a way indicates that despite the vast potential for rural market, the formal institutions have not been able to extract the best result. The formal institutions have been able to cover only 21.65 percent of the potential market demand for credit. The SBI branch at Hatsingimari, which covers the Fekamari Development Block, has only 10 percent of the outstanding credit under bank finance while 58 percent is under govt. sponsored programme and 32 percent under PMRY. Most of the loans (85%) are medium term loans. However, of the total gross advances of the branch, 63 percent is NPAs. Of the total loan under agriculture, 82 percent has become NPAs while 98 percent of the PMRY loans have become NPAs.

The survey reveals that demand for production credit is higher than consumption credit. The smaller size of consumption loans of less than Rs 10,000 are usually borrowed to meet the immediate exigencies, while loan sizes varying between Rs 10,000 to Rs 30,000 are taken for special purposes, like marriage of children, brothers, sisters, etc. The average rate of interest hovers around 10 percent per month, for a maximum period of eight months. However, it may be mentioned here that size, rate of interest, period of loan for consumption and production purposes are same in respect of moneylenders. The per month interest liability of a borrower is, thus, estimated to be as follows (table-11):

Table 11: Amount, Rate of Interest, Period of Loan and Interest Liability for Moneylenders' Loan

Sl. No.	Principal (amt. in Rs.)	Rate of Interest (per month)	Period of Loan (in months)	Interest amount (Rs. per month)
1	3000	10	3	300
2	10000	10	6-8	1000
3	15000	10	8	1500
4	30000	8	8	2400

Source: Field Survey, 2004

Therefore, a person who borrows Rs 30,000 @ 8 percent rate of interest per month has a total liability of Rs 49,000 if he borrows for a period of 8 months. In other words, Rs 19,200 forms the total interest component of a loan Rs 30,000 for a period of less than a year.

Compared to the interest component of a loan from money lender, the interest burden per month for a loan from formal institution i.e., bank is much lower. The estimated interest burden per month for bank loan is as follows (table-12):

Table 12: Amount, Rate of Interest, Period of Loan and Interest Liability for Bank Loan

Sl. No.	Principal (amt. in Rs.)	Rate of Interest (per month)	Period of Loan (in months)	Interest amount (Rs. per month)
1	20000	0.75	36	150
2	30000	0.83	36	249
3	20000	0.83	60	166
4	9000	0.83	60	74.7
5	25000	0.92	60	230
6	100000	0.92	60	920

Source: Field Survey, 2004

A comparative analysis shows that for a loan of Rs. 30,000, the per month interest burden in respect of moneylenders' loan is ten times higher than that of a bank loan. Further, the periodicity of the loan is also longer in respect of banks.

The existence of this credit demand and subsequent repayment shows that rural areas have sufficient demand for credit. Moreover, the relation between rate of interest and repayment is found to seemingly proportional- higher the rate of interest (money lenders' loan), faster is the repayment; lower the rate of interest (bank loan), slower is the pace of repayment. Thus, while credit demand is interest inelastic, loan repayment is directly related to rate of interest.

The demand for credit in sample households engaged in trade is found to be higher vis-à-vis other occupations and, the average loan size is less than Rs. 30,000. Significantly, while only one farmer has borrowed from bank, rest of the farmer households in the sample has borrowed from money lenders. This corroborates the declining trend in off take of bank credit for agriculture.

❖ INCOME AND INTEREST BURDEN

Based on the sample observations, an attempt has been made to estimate the financial burden of a loan from a moneylender compared to that of a bank loan on a borrower household.

The estimated per month income of a borrower household is found to be Rs. 3,800/- while monthly consumption expenditure is Rs. 3,500/-. If the interest burden of a moneylender's loan is now added to his monthly expenditure, then the emerging picture is as follows (table-13):

Table 13: Amount, Rate of Interest, Period of Loan, Interest Liability and Income-Expenditure Gap for Moneylenders' Loan

Sl. No.	Principal (amt. in Rs.)	Rate of Interest (per month)	Period (in months)	Interest Amt. (Rs. Per month)	Avg. monthly Income (in Rs.)	Avg. monthly Exp. (in Rs.)	Total monthly Exp. (in Rs.)	Income-Exp. Gap (in Rs.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)=(4)+(6)	(8)=(5)-(7)
1	3000	10	3	300	3800	3500	3800	0
2	10000	10	6-8	1000	3800	3500	4800	-1000
3	15000	10	8	1500	3800	3500	5000	-1200
4	30000	8	8	2400	3800	3500	5900	-2100

Source: Field Survey, 2004

Table 14: Amount, Rate of Interest, Period of Loan, Interest Liability and Income-Expenditure Gap for Bank Loan

Sl. No.	Principal (amt. in Rs.)	Rate of Interest (per month)	Period (in months)	Interest Amt. (Rs. Per month)	Avg. monthly Income (in Rs.)	Avg. monthly Exp. (in Rs.)	Total monthly Exp. (in Rs.)	Income-Exp. Gap (in Rs.)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)=(4)+(6)	(8)=(5)-(7)
1	20000	0.75	36	150	3800	3500	3650	150
2	30000	0.83	36	249	3800	3500	3749	51
3	20000	0.83	60	166	3800	3500	3666	134
4	9000	0.83	60	74.7	3800	3500	3575	225
5	25000	0.92	60	230	3800	3500	3730	70
6	100000	0.92	60	920	3800	3500	4420	-620

Source: Field Survey, 2004

On the other hand, if we add the interest burden of bank loan to the monthly expenditure, the result will be as shown in table-14.

A comparison of the total expenditure (per month) of a borrower household (inclusive of interest) shows that a person taking a loan from a moneylender ends up in a virtual *debt trap*. It is evident from the above two tables that the total expenditure of a borrower household in the event of a bank loan still leaves him with surplus in his hand for comparable amounts from a moneylender.

The accessibility of small borrowers like daily wage earners gets severely restricted in formal institutions. Evidence from the survey reveals that daily wage earners have a monthly income of Rs.833.00 per household and the expenditure per month is Rs. 808. The need for additional money of Rs. 6000.00 to start a small petty business forces him to go to the moneylender to borrow the amount at seven percent per month for six months, in unilateral terms. The prime reason for going to the money lender is the absence of any condition in extending the loan amount. The insistence of security margin in banks forces these small borrower groups to stay away from formal agencies.

While small size production loan by small income groups in the survey block of Fekamari in Dhubri district is obtained from money lenders or friends & relatives, however, households with higher levels of income have approached banks for production loans. The household with a monthly income of Rs. 9000 (also highest monthly per family expenditure) from non-agricultural activities have taken production loan of Rs. 30,000 from commercial bank for 3 years at 10 percent rate of interest per annum. However, the same household who required additional fund for social obligation (consumption loan) borrowed from the local moneylender. While his rate of interest for bank loan is 10 percent per annum, his consumption loan carries 120 percent rate of interest per month i.e., 120 percent per annum for six months on Rs. 10,000/.

The following table (Table-15) shows five individual cases, where four have borrowed from banks for production purpose and also from moneylenders for consumption purpose. There are two dimensions in the table: first, it is clear that a loan of rupees one lakh does not carry as much interest burden as the moneylender's small loan of rupees one thousand does. Also, the difference in the loan sizes for each of the four borrowers between consumption and production loans is negligible. This essentially shows that new credit products for rural borrowers have to be developed which can cater to their consumption

Table 15: Distribution of Borrowers w.r.to Profession, Monthly Income, Expenditure, Loan Size, Period, Interest Burden etc.

Profession	Monthly In- come (in Rs.)	Monthly Ex- penditure (in Rs.)	Production Loan (Amt. in Rs.)	Period (in months)	Interest Amt. (Rs. p.m.)	Consumption Loan (Amt. in Rs.)	Period (in months)	Interest Amt. (Rs. p.m.)	Total Monthly Expenditure (in Rs.)	Income- Expendi- ture Gap
Others	9000	7500	30000	36	249	10000	6	1000	8749	251
Petty Business	4166	4166	20000	60	166	10000	8	1000	5332	-1166
Retail Trade	7083	5833	20000	36	150	30000	8	2400	8383	-1300
Retail Trade	6666	6250	25000	60	230	18000	8	1620	8100	-1434
Commercial Agriculture	4166	2916	100000	60	920	-	-	-	3836	330

Source: Field Survey, 2004

Second, it has been revealed from discussion with the borrowers that a portion of production loan taken from bank is used sometimes for repayment of past loans taken from money lenders. Thus, even though borrowers avail loans in the name of using for production purposes, a sizeable amount is diverted for repayment, either fully or partially, of past loans taken from moneylenders. In fact, it is quite logical for a rural household to approach a moneylender for his immediate credit requirement and also borrow from bank, which gives him the opportunity to get cheap funds to pay off an expensive credit of the money-lender.

This shows precisely how schematic lending in India have found their way to moneylenders' coffers, creating a rural elite and reinforcing their business. Moreover, rural finance has historically become a social obligation rather than a potential business opportunity. Most often, bankers take a narrow and fragmented view of the rural market segment and resist any non-traditional approaches. The rigid systems and procedures result in time delays for the borrowers and de-motivate many potential customers to approach banks for loans. Therefore, while banks are physically present in rural areas and offer loans at concessional interest rates, rural borrowers are not able to access them.

❖ INFORMAL LENDERS

The composition of sample moneylenders as shown in table-16 reveals that agricultural farmers and businessmen are the dominant groups. It is significant to note here that the high rate of return from lending activities have also brought in salaried employees of fourth grade into the business. It is also evident from table-18 that higher is the annual family income, higher is the quantum of money into circulation. Three lenders (comprising two agricultural farmers and one businessman) who have annual income of more than one lakh reported more than one lakh rupees in circulation. 57% of the total money in circulation of the ten lenders is provided by them.

Table 16: Distribution of the Lenders w.r.t Main Occupation

Occupation	Nos.
Agriculture	3
i) Subsistence	0
ii) Commercial	3
Non-Agriculture	7
i) Wholesale Trade	1
ii) Retail Trade	0
iii) Petty Business	2
iv) Salaried Service	2
v) Wage Labourer	0
vi) Others (moneylending)	2
Total	10

Source: Field Survey, 2004

Table 17: Distribution of Lenders w.r.to Annual Income and Annual Expenditure

Annual Income (in Rs.)	Annual Expenditure (in Rs.)									Total Nos.
	30000	70000	78000	85000	90000	95000	96000	120000	140000	
25000	1	0	0	0	0	0	0	0	0	1
45000	0	1	0	0	0	0	0	0	0	1
50000	0	1	1	0	0	0	0	0	0	2
60000	0	0	0	0	1	1	0	0	0	2
65000	0	0	0	0	0	0	1	0	0	1
70000	0	0	0	1	0	0	0	0	0	1
85000	0	0	0	0	0	0	0	1	1	2
Total Nos	1	2	1	1	1	1	1	1	1	10

Source: Field Survey, 2004

Table 18: Distribution of the Lenders w.r.t Annual Income and Amount in Circulation

Annual Income (Rs.)	Amount in Circulation (Rs.)						
	20000	45000	50000	60000	80000	100000	200000
30000	1	-	-	-	-	-	-
70000	-	1	1	-	-	-	-
78000	-	-	1	-	-	-	-
85000	-	-	-	1	-	-	-
90000	-	-	-	-	-	-	1
95000	-	-	-	-	1	-	-
96000	-	-	-	-	1	-	-
120000	-	-	-	-	-	-	1
140000	-	-	-	-	-	1	-

Total no. of lenders=10
Source: Field Survey, 2004

The myth that moneylending in villages or rural areas is dominated by wealthy landlords is not true in respect of present study. Here, even households with annual income of Rs. 30000 or, more precisely, with monthly income of Rs. 2500 have also entered into the profession as rate of return is calculated to be higher by the lender compared to any other investment.

Table 19: Distribution of the Lenders w.r.t Land Holdings

Land Owned (in bigha)	No. of Lenders
0 – 7.5 (Marginal)	6 (60%)
7.5 – 15 (Small)	1 (10%)
15 – 30 (Semi-medium)	1 (10%)
30 – 75 (Medium)	2 (20%)
75 & Above (Large)	0 (0%)
Total	10 (100%)

Source: Field Survey, 2004

Table-19 reveals that 60% of the sample lenders are marginal land holders unlike the traditional notion that money lenders are big landlords. There is no single definite identifiable reason for this. Most of the households in the survey

area have land holding sizes even less than the marginal plots (which includes borrowers and lenders alike). Even though collateral is accepted as security, land transfer does not take place because of the strong social pressure exerted on the money lender to forgive the defaulter under the *dewani* system, a local village dispute settlement arrangement. An important aspect found in the surveyed villages is the presence of strong sense of social cooperation among the villagers in so far as land ownership rights are concerned. The landownership rights ensure citizenship of a country. The Fekamari block which is essentially Muslim majority comprising of people with dialects similar to people from East Pakistan (now Bangladesh) faces threats of immigrant eviction. However, the landownership title acts as a safeguard to the genuine Indian citizens. This sentiment for fellow members of the villages or in other villages of the blocks whose families have been living there for years together has been found to be strong among these money lenders and which also finds its legitimacy in the *dewani* system of the villages. Therefore, one finds evidence of money lenders without possession of vast land holdings in the surveyed area.

However, the risk of lending is ensured by the lenders under physical mortgage of livestock (cattle and buffaloes) and gold ornaments. The land documents are taken in principle, but in practice, are not handed over. In the event of default, the amount is repaid either by selling the livestock or transferring the gold ornaments to the money lender. Therefore, the borrower does not lose his plot of land, but has to make up for his default by either parting with his livestock or gold ornaments in lieu. The price of a cow or buffalo in the local market on an average is Rs.6000/- and Rs.12,000/- respectively, and which is easily saleable and brings in fast cash. Hence, opportunity cost of livestock as security is much higher than collateral security in respect of marginal productivity of profit for the lender since fast cash is more in demand in an income poor economy.

One of the objectives of this survey has been to find evidences, if any, on cross border money lending since the international border with Bangladesh along these villages are alleged to be one of the entry points for immigrants from Bangladesh. However, this Study has found no such evidences of cross border lending even though there are pockets of cross border informal trade which is in barter terms.

❖ RATE OF DEFAULT

Classifying the lenders into three categories based on the amount of money in circulation viz., big lenders (Rs 1 lakh to 2 lakh), medium lenders (Rs. 50,000/- to Rs. 80,000/-), and small lenders (Rs. 20,000/- to Rs. 45,000/-), it is found that the highest rate of default has been in case of both old and new entrants to the business with larger amount in circulation as shown in table-20. Lower the quantum of money in circulation, lower is the rate of default. Of the total money in circulation from the ten lenders, the percentage of default is 14.46 percent. Further, it is seen that the total default rate for the three big lenders (Rs 1 lakh to 2 lakh) is 22%. For the second category of lenders (Rs. 50,000/- to Rs. 80,000/-), the total default rate is 4.06%. While for the small lender groups (Rs. 20,000/- to Rs. 45,000/-), the total default rate is 7.69%.

Table 20: Distribution of the Lenders w.r.to No. of Years in Business, Amount in Circulation and Default Amount

No. of Years in business	Amt. in circulation (Rs.)	Amt. Default (Rs.)	Percentage of Default
10	200000	50000	25%
10	200000	30000	15%
3	100000	30000	30%
10	80000	0	-
5	80000	13000	16.25%
6	60000	0	-
3	50000	0	-
8	50000	0	-
10	45000	5000	11.1%
8	20000	0	-
Total	885000	128000	14.46%

Source: Field Survey, 2004

Table 21: Category of Lenders and Their Borrower Groups

Category of Lenders	Major Borrower Groups
Big lenders	Salaried employees (mainly govt. service holders), and petty traders.
Medium Size lenders	Salaried employees, petty traders and, farmers/cultivators.
Small lenders	Petty traders, farmers/cultivators and, daily wage earners.

Source: Field Survey, 2004

A look into the distribution pattern of the clients of the ten lenders (table-21) shows that agricultural farmers do not find preference. Further discussions in the survey area has revealed that seasonality of income with agriculture is the single most important factor which makes the big lenders shy away from lending to farmers in the area. They prefer to lend to people in government service or involved in trade as risk of default is lower since these people have a regular flow of income making it easy to repay the loan amount. On the other hand, the income poor agricultural families in the survey area move to the medium size money lenders for their credit requirements. It is significant to note here that since maximum amount a cultivator household borrows is Rs.10,000/-, the small moneylenders are the offshoot of this demand from the agricultural farmers. The sample of lenders in the study shows that as many as nineteen cultivators have borrowed from small lenders while sixteen cultivators have borrowed from medium size lenders but loan sizes are less than Rs.10,000/-. Field discussion reveals that even medium size borrowers are wary of the seasonality of income of the farmers and hence are 'careful' in extending credit. However, as the demand for credit remains, small time lenders have ventured into the business. Another important section of borrowers, viz., the daily wage earners who have no access to credit either from big or medium lenders have found their access to credit with the small lenders. Thus, the lowest rung of the income poor village population face same inaccessibility in respect of credit from the money lenders in as much the same way as faced by the average income earning rural family from the formal agencies like banks.

The survey further reveals that the average credit requirements for different groups of borrowers viz., petty traders and service holders (mostly govt. services) hovers around Rs.1000-Rs.10,000/- while for farmers it is around Rs.1000-Rs.5000/-.

It is pertinent to note that access to credit whether from formal institutional agencies or from informal agencies is equally challenging for income poor farmers due to the seasonality of income which carries with it a high default risk. Given the fact that a large proportion of medium and large size farmers obtain credit from informal agencies, it is obvious that small and income poor farmers would be obviously left outside the ambit of informal agencies as well. (Singh: 2000). Further, there is a positive correlation between the farm size and the credit size even with the informal agencies. Dandekar and Wadia (1990)

concluded that marginal farmers and landless labourers remain discriminated. In states like Punjab also, it has been found that farmers cultivating more than five acres are capable of availing long term institutional finances. (Singh: 2000).

❖ CRITICAL ISSUES

On one hand the survey throws the potentiality of a vibrant active credit market and on the other the inaccessibility of the formal institutions is intriguing. The remedy for the rural credit market can not be found if only the formal supply of credit is addressed. The buyers of credit products i.e., the borrowers are also responsible in the rural areas.

A village shop in Fekamari sells MNC products like Pepsi and Uncle Chips and, the clientele is none other than the poor villagers who succinctly distinguish between total Indian made and MNC products. The evidence from the field study reveals that borrowers are fully aware of the qualitative differences in the branded consumer durables of various companies. Thus market sensitivity is thoroughly present in the rural areas. Further, the enquiry also reveals that all the borrowers are fairly aware of the benefits of formal credit (low interest rate and longer repayment) against the high cost credit from money lenders. The notion of anything from government agency is always gratis is also fairly strong among the sample borrowers, thanks to the subsidised credit programmes.

The rural credit markets in underdeveloped areas are distinct from urban areas and, the credit products needed for such markets cannot be effectively addressed by the delivery system of the commercial banks which is more geared towards educated clientele in urban areas. Even the average size of production loans do not vary significantly from the consumption loan. The estimates of the loan sizes from the survey reveal that production loan is only 1.12 times higher than the consumption loans. In other words, the household income does not suffice to meet the emergencies of the rural families and the cash for non productive uses is, therefore, comparatively high. Since institutional credit products for various consumption purposes are tailored to serve basically urban clientele, the rural areas are thereby left out. The critical minimum requirement as has been emphasized time and again is savings, by the rural households. As found in the survey, 45 percent of the borrower households

have no savings (table-22) while 55 percent who have savings, first spend it on their consumption needs.

Table 22: Distribution of Borrowers w.r.to Types of Savings Scheme

Monthly Saving Scheme	No. of Borrowers
SHG	15
Bank	4
None	19
others	1
SHG+Bank	1
Total	40

Source: Field Survey, 2004

Unlike urban areas where borrowers plan their credit needs and demand, in rural areas, the demand for credit is not planned except in respect of social functions like marriage. The demand also requires urgent and immediate redressal. The formal institutions' credit delivery mechanism is not geared to this end and, hence, the informal agencies cannot be wished away from the scene through legislations. Further, one also cannot shy away from the fact that cash & barter transactions are still convenient for illiterate & uneducated rural poor.

Therefore, supply of consumption loan in rural areas has remained an exclusive domain of the moneylenders, since the information asymmetry tends to be lower. The high seasonality of income also attaches higher risk of default vis-à-vis production loan. Higher the asymmetry of information, higher is the risk of default. The high rates of recovery (85%) by the sample moneylenders for loans which are all short-term with maximum one year period indicate that 'trust' and 'information access' between both is the major determining factor. Therefore, asymmetry of information between formal institutions and the client group (borrowers) is a major hindrance in the flow of credit in rural areas from formal sources. As moneylenders are the only source of credit, hence, timely repayment leaves open the future scopes of borrowing.

The survey reveals that 28 percent of the sample borrowers are illiterate, 28 percent of the borrowers have obtained formal education up to either primary or middle level (table-23). Thus 56 percent of the borrower households are almost illiterate in respect of formal procedures of lending which has been

further observed in the course of field discussion during the survey.

Table 23: Distribution of the Lenders and Borrowers w.r.t Educational Attainment

	Educational Attainment							Total
	Illiterate	Up to Primary	Up to Middle	Up to HSLC	Up to HS	Up to Graduation	Graduation & Above	
Lenders	1	1	3	3	0	1	1	10
Borrowers	14	8	6	6	2	4	0	40
Total	15	9	9	9	2	5	1	50

Source: Field Survey, 2004

Therefore, given the volume of information required to be furnished in the bank loan application, and the inability to fill up the form by oneself with one's scanty learning and wisdom, the borrowers prefer to manage the required credit from elsewhere. Thus educational attainment of a society is an important factor in the emergence of formal credit agencies. It is worth noting that the economic transition from barter to cash economy and then to cheque and on to credit economy is directly correlated with increase in economic prosperity and the educational attainment of a society.

Table 24: Average Percentage of income Spent on Different Expenditure Heads by the Borrowers and the Lenders

Expenditure Heads	Average Percentage of Income spent	
	Lenders	Borrowers
Food	36.95	61.99
Clothing	5.93	7.79
Medical	5.00	5.70
Festival	7.09	7.52
Education	10.34	6.91
Others	4.15	2.44
Total	69.46	92.35

Source: Field Survey, 2004

As estimated from the sample, the average annual income of the lenders almost doubles that of the borrowers. The lenders are left with an average income of Rs. 27900/- as surplus after meeting all their annual expenses. This accumulating surplus is the main source of their loanable funds. Further, insights into the average annual expenditure for two groups (the borrowers and lenders) show that the expenditure on food occupies the largest share in the family budgets of both the borrowers as well as the lenders (table-24).

However, it is evident from the table that the percentage of income spent on food is higher for the borrowers (61.99%) compared with that of the lenders (36.95%) which is in conformity with Engel's Law: *proportion of income spent on food decreases at higher levels of income*. Notwithstanding the high proportionate share of expenses on food for both the groups, the data shows that the lenders' percentage share on education in his total expenditure basket is almost double that of the borrowers. The income poor borrower family fails to spend on education adequately and, is perhaps, one important factor for higher illiteracy in the area.

Therefore, shortage of credit cannot be viewed as merely a financial burden on the income poor borrower family but, more importantly; it is a vicious social burden which is, perhaps, one important factor for growing rural urban divide in backward areas like Fekamari bloc.

The above statement does not claim any generalization. Rather, the issue has been raised here to expand the scope for further research in demand and supply of credit in rural areas and, bring out the specificities of the credit market at the micro level and how best the macro policies address these issues from a practical point of view for both borrowers and the formal agency lenders within the existing norms and set up, rather than trying out new alternative models.

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