THE INDIAN JOURNAL OF AGRICULTURAL ECONOMICS

(Organ of the Indian Society of Agricultural Economics)

Vol. II	AUGUST 1947	No. 2.

CONFERENCE NUMBER

PROCEEDINGS
of the
SEVENTH CONFERENCE
held at Karachi, December, 1946.

SUBJECTS

1. Costs in relation to size of Farms.
2. Methods and Objects of Rural Surveys.
3. Problems of Rural Credit.
4. Abolition of Zamindari.

Rs. 3/- per copy.

THE INDIAN SOCIETY OF AGRICULTURAL ECONOMICS
BOMBAY.

AIMS AND OBJECTS.

To promote the investigation, study and improvement of the economic and social conditions of agriculture and rural life through:—

(*a*) periodical conferences for the discussion of problems;

(*b*) the publication of papers, separately or collectively; or in a periodical which may be issued under the auspices of the Society;

(*c*) co-operation with other institutions having similar objects, such as the International Conference of Agricultural Economists and the Indian Economic Association; etc.

CONTENTS

RURAL LOAN LENDING POLICIES—A PROBLEM OF THEIR REVISION

By

PROF. P. N. DRIVER,

Professor of Agricultural Economics, College of Agriculture, Poona.

Problems of Indian rural credit are many. Due to paucity of space I shall restrict myself in this paper only to a consideration of the much needed revision of our lending policies.

It is of course well-known that the roots of the tragedy of our rural debt lie deep in the evils of our present system of *uncontrolled* credit operating through the anarchy of our Sowcari System. What we lack are concrete suggestions which can point the way to the reforms in lending for as our lending policies change there will be changes in other directions also such as loan repayments, debt adjustments, etc.

Though our rural debt is very high it should be clear to most people that the main tragedy of our rural debt does not lie in its total volume. It is significant to note that though our agriculture is not prosperous, our agricultural debt even in a period of Depression (1933) was less than the total farmers' debt in such a prosperous country as U.S.A. as far back as 1910 which was by no means a year of trade depression.*

The principal tragedy of our rural debt is that it has increased very rapidly and the main cause of this increase appears to be (*a*) wrong and unscientific policies and procedure in lending and repayments and (*b*) an equally wrong and unproductive use of loans.

The first great step in credit reconstruction is to stop the use of loans for unproductive purposes. This, however, is not so easy as some reformers believe. The causes of unproductive use of loans are mainly two. The first cause is the absence of "controls" of any kind in lending loans. For the Sowcar there are no "controls" and all loans are controlled by his greed alone. The productive use of a loan is totally unimportant to the Sowcar so long as the crop and other property of the cultivator are within his grip. He does not feel that it is his business to guide the borrower in the use of a loan. Side by side with this first cause is a second cause which is often forgotten—the unproductive nature of our agriculture. In a country where farming is not always profitable many a loan used even for a productive purpose becomes unproductive in its results.

How to stop the use of loans for unproductive purposes and what "controls" we should introduce are, therefore, not easy problems to solve. First, we should avoid any kind of theoretical oversimplification. Writers like F. L. Brayne, for example, think that since unproductive loans are bad all credit for unproductive purpose should be reduced to *nil*†. It is difficult to agree with this view for a loan policy that makes no provision for consumption credit appears both unattainable and undesirable. First, some consumption credit is socially necessary in a country like ours where the

* Our total debt in 1933 was estimated to be about 1,200 crores by Dr. P. J. Thomas (p.176, "Economic Problems of Modern India"—Vol. I, Edited by Radhakamal Mukerjee) while the total amount of the farmers' debt in 1910 was estimated to be about 5,000,000,000 dollars by the United States Department of Agriculture.

† F. L. Brayne, "Better Villages," p. 226.

illiteracy of the masses is as great as their social obligations. Besides, such credit is even essential from the productive view point as when a crop is destroyed or prices fall heavily or when all the capital of a farmer is used up in ploughing and sowing operations.

But after making allowance for the importance of consumption credit in a country like ours, our first duty is to stop the use of loans for all avoidable unproductive purposes. Where most of the loans given are used for such purposes most of our energies must be directed to stopping this. It is significant to note that in certain parts of the country as much as 94 per cent. of the loans are reported to have been used for unproductive purposes. The present system, where the lender is not interested in the productive use of loans, is a source of great danger for it is completely destructive of all thrift and of prosperity in general. There can be no doubt therefore that what we need is the imposition of "controls" or limits in credit and this again requires the introduction of a credit agency with an educative and supervisory function. One of the capital crimes of the Sowcar is that he has debauched our cultivators with plenty of money during booms and periods of rising land values. This has also to stop at once.

The best way to stop giving money for wasteful purposes is to have a policy of lending which is related to factors like (*a*) the productive capacity of a farm, (*b*) the farmer's need for capital and (*c*) the rate of capital turnover. In many cases it will be discovered that the productive capacity of our farms is very low compared to the farmer's need for capital and that it is not possible for a farmer to pay for a farm, even during his life time. It is true that in future we are thinking of having larger farm units and also of greater use of machinery and of developments in technology. Whilst this will increase our productive capacity the danger of the farmer borrowing capital much beyond his financial limits will persist. In fact even in countries with advanced technology many farmers are not able to pay for a farm during their lifetime because their capital requirements grow very large.

Since our productive capacity is low, lending should be based less on the value of land or of the ornaments and other property of the farmer than on his intrinsic productive capacity. We must not ignore the distinction between loans which are safe and loans which are sound. The Sowcar never rejects a loan application where security appears good. But such a loan may not be sound loan. Since good security does not in itself mean good productive capacity. A loan secured by ornaments of a farmer's wife may be safe to the lender but unsound from the borrower's view point if his productive capacity is not good. On the other hand if productive capacity is good and the loan is used for production alone then the absence of security is not so important since such a loan is a sound loan and the productive purpose itself creates its own security.

We have to remember that our low productive capacity is one of the most important of the causes of the failure of agricultural credit in India. Hence, apart from the need for supervising the farmer's operations, and the stoppage of the wasteful use of loans, *our new credit organisation will have to plan for such adjustments in the use of credit as to increase the income of the farmer*. This may mean both a *reduction* in the use of credit in certain directions as well as an *increase* in its use in other directions. We shall need for this purpose provincial organisations for careful planning in farm management as also a large number of farm surveys.

To begin with we want to know in what directions we can reduce the cultivator's seasonal credit requirements. We have been told that he is unemployed for many days during the year. Can he not be induced to put in more labour of himself and his family for producing many things which he buys to-day with the help of the Sowcar's loan? Do all farmers, for example, produce all the food they need? Do they buy some of the food which can be produced at less cost in their own village? There is also the question of purchase of manufactured goods which they need not purchase at all but only produce themselves. The question of reducing the expenses of purchasing on credit at a very high cost various things from the village shop-keeper is also very important.

Proper adjustments in the use of credit also involve a careful scrutiny of the balance of the farm debts of our farmers. Farm debts are sometimes so poorly balanced that a good credit organisation can set right for the farmer what was a serious cause of his ruin before. A cultivator for example may have given away as security all his crops and his cattle and may yet have very little debt on his actual land. In such a case he may not be able to get his essential working capital and may suffer though he may be credit worthy and can get money if he gave up his objection to any kind of debt on land. The reverse of this is also possible, for a farmer may have very heavy land debt and comparatively very light short-term debt. His heavy land debt may prevent him from returning his instalments without great trouble whereas all this trouble could be avoided if he balanced this kind of debt with other short-term debt.

Adjustments in the use of credit not only imply a reduction in its use but also an increase in its use where the use is very productive. The borrowing of money to pay cash for supplies rather than have the supplies on future payment often saves the cultivator several times the cost of such borrowing. Even in a comparatively more prosperous country like U.S.A. the system of charging time prices (instead of cash) represents an equivalent of a very high annual interest rate. Special surveys made in various parts of U.S.A. like South Carolina and Oklahoma, showed that the cost of merchant credit to the farmer purchasers was as high as 31.6 and 34.8 percent.* The buying of seed, fertilisers, etc. for cash from loans borrowed saved farmers this expense.

In this as in other countries there are uses of credit which can prove very fruitful. For example, expenditure on farm compost as prepared by the Department of Agriculture in Bombay, may prove more worth while than it is supposed to be for it may increase in the long run the output and therefore the net returns of the cultivator. In the same category is the use of credit for good seeds or for anything else which can make it possible for the farmer to make his equipment more efficient or use his labour more fully. Credit for use in several directions as follows is worth noting:—

1. Drainage Operations.
2. Cropping programmes to increase Soil fertility.
3. Cattle Breeding or Dairying as Supplementary Operation.

It is of course true that in India the scope for increased use of medium term and long-term credit like this requires careful inquiries and farm surveys. We have not to forget that in case of farms which are heavily indebted expenditure on items like these will not be profitable within three to five or more years. What is more important if the annual charges on most of our farms are very heavy compared to productive capacity any increase in the fixed annual charges would be ruinous unless, (*a*) a special credit organisation is set up so as to reduce to practically nothing the rate of interest as well as the principal charges during the first few years and, (*b*) credit for these purposes is given only to farmers who are not heavily in debt.

Most people in India know that farm loans are of three kinds, short-term, intermediate-term, and long-term. Unfortunately very few people realise that the mixing

* Referred to on p. 34 of "Federal Seed-Loan Financing and its Relation to Agricultural Rehabilitation and Loan Use." by Norman J. Wall (United States Department of Agriculture).

up of these three kinds of loans and the lending of them by the same credit agency—whether it be a Sowcar or a Co-operative Society—has been one of the important causes of our present credit complications. A very clear separation of these loans is required as each of these three kinds of loans has problems of its own and the sources of capital, nature of security, rate of interest, mode of repayment, time of repayment, etc., are all different. A detailed analysis of our farmers' different credit requirements has to be made if we are going to have different institutions to supply long-term and short-term credit.

There is no doubt whatsoever that for short term loans no banking system can be better than the Co-operative System. This was the view of Herrick* in 1910 and is the view of modern experts like Boyazogluf to-day. We have no reason whatsoever to differ from this view if we realise the importance of *popular control* in agricultural credit and of the necessities of short-term credit like need for contact with and supervision of the borrower, and a full knowledge of his operations.

The requirements and methods of long-term credit being entirely different from those of short-term credit neither our co-operatives nor our Sowcars should be allowed to supply such credit. In fact it is safer to allow mortgage institutions to give also short-term credit than allow Raiffeisen institutions to give mortgage credit. In India except for a few Land Mortgage Banks we have done nothing to organise long-term credit institutions. This is an important problem for the future.

The problem of medium-term loans is equally complicated. In most countries of the world we have as yet no special institutions for supplying these loans with the result that they are supplied by either short-term or long-term capital supplying institutions. This has not given good results. The giving of loans for 3 or 5 years for purposes like purchase of bullocks, etc. by our credit co-operatives has been very dangerous and has led to many miscalculations in repayments. I am sure the requirements of our farmers for this type of credit will grow as we have seen in an earlier paragraph. A very important source for supply of such loans ought to be our industries which produce all those implements, fertilisers, etc., which are likely to be bought by our farmers to-morrow. Such industries can be granted guarantees by the State or by other credit institutions.

A very important problem in rural credit is that of lending to the farmer just what is necessary—neither more nor less. Though inadequate lending is our main difficulty the solution for the problem of inadequate credit is not more credit in itself but more "controlled" credit. In every period of booms and rising prices the farmer gets more credit but this ruins him as much as inadequate credit. As uncontrolled credit rises the tendency is for the debt to rise also and this results sooner or later in expropriation of peasant proprietors in favour of capitalist absentee landlords. We should not forget that if inadequate credit is the Devil, more facile and uncontrolled credit is the Deep Sea. Our problem is to set up a lending organisation that can steer clear between them both.

The peculiarity of the Sowcari System is that instead of lending just what is necessary and neither more nor less it has always lent either more or less—and what is worse it tends to lend more when it should be less and less when it should be more. Thus we have had both over-loaning and land speculation on the one hand and inadequate financing on the other. Private money lenders are always prepared to lend too much when they should really be taking back their loans—in a period of rising prices and prosperity. On the other hand when prices fall and more credit than

* Herrick, "Rural Credit," p. 9.

† Boyazoglu, "Agricultural Credit," p. 107.

normal is needed they cut down their lending even below normal and are only too prepared to take back instead of lending.

The real point to remember is that a period of rising prices is the right time for loan repayments by the farmer whereas a period of falling prices is the right time for giving extensions, for adjusting debts, and for giving fresh emergency finance. The Sowcar as a credit agency will never be able to do this. We can hardly blame him for he is but human and, moved as he is by self-interest, he becomes nervous about lending when he should lend whilst on the other hand he is tempted to invest more and more in a boom period. Since the self-interest of the Sowcar conflicts with the interest of the farmer we have to uproot the Sowcari System, lock, stock and barrel, and replace it by a system organised to serve the interest of the cultivator.

The credit system which we need is one under which we can lend at a time when the private money lender is frightened to lend and also insist on repayments at a time when the private money lender is only too willing to debauch the farmer with more money. Both lending as well as repayments have to be adjusted to suit the interest of the borrower and not of the lender of rural credit. If this point is borne carefully in mind we shall realise that neither the Sowcar nor the ordinary commercial bank is suitable for rural credit. If the Sowcar has to look to his own individual profiteering interests, a commercial bank has to look to the interests of hundreds of its own Sowcars—the shareholders—and give them maximum profits. Let us remember that no institution which aims at profit making in its proper sense as its principal object can finance Indian agriculture.

BANK OF ISSUE AND RURAL CREDIT WITH SPECIAL REFERENCE TO INDIA

By

KRISHNA KUMAR SHARMA,

Meerut College, Meerut.

In this brief article it is proposed to make a survey of the part that the Central Bank of a country should play in the organization of rural credit machinery. In our country the Reserve Bank has been in existence for about 12 years, but our rural credit machinery has not yet been organized as much as it ought to be. It may appear to be an abstract subject ; but abstraction and analysis are necessary to a correct understanding of the situation. An efficient and adequate credit organization is necessary for agriculture. It should satisfy certain tests.

(1) The resources of the money market should be tapped at a reasonable cost, though as Belshaw observes[1] " A permanent disparity between the rate of interest in agriculture and industry is not *prima facie* evidence that the charges are less fair in one than in the other ; for there may be an irreducible margin of difference in inherent conditions which organization cannot remove or which necessitates types of organization involving greater costs than those needed to market credit to other types of enterprise."

(2) Risk to the lender should be reduced to the minimum.

(3) The flow of credit must be directed in such a manner that monopoly element does not appear and there are no hindrances to the free movement of funds. From the point of view of the borrower credit should not be costly and loans should be granted for a period of time so that the cultivator can repay them without difficulty.

Page 83 : Provision of Credit with special reference to Agriculture.