CHAPTER VII

INTERLINKAGE OF CREDIT WITH OTHER FACTOR MARKETS

7.1 Theoretical Perspective on Interlocked Agrarian Factor Markets and Informal Finance.

In an underdeveloped agrarian economy like India, it is very often seen that transactions in rural credit market are interlocked in a significant way in the sense that a transaction in one market becomes contingent upon a transaction in another market. Informal lender and borrower enter into several transactions at the same time. The lender interlinks credit with land, output, labour and input markets. Thus, interlinkage of credit with other factor markets is said to have taken place when contracts regarding several interdependent market transactions are simultaneously agreed upon between the same parties.

In a credit transaction, a current claim over resources is exchanged for future ones. But as the delivery of future repayment of credit is not sure and, or accompanied by risk and uncertainty in the absence of any insurance market, the credit transaction becomes a peculiarly "Contractual Character" (Bell, 1988; 766). Lenders to be assured of the future repayment of credit from the borrower-cultivators make a detailed searching of the mode and capacity of repayment of credit and tie them (borrower-farmer) with different provisions of contracts they offer to the borrowers (ibid. 1988). It is not that the lenders are assumed to deliver credit without any collateral. Here they deliver credit with non-marketable or non-conventional collaterals like a promise of labour services, or a promise to sell crops to the lenders or a promise to buy agricultural inputs from the lenders. Lenders prefer to interlink credit with one or more market because it reduces the risk of default of credit (Basu, 1984b), or it is a source of additional monopoly for the dominant party in such interlocked transactions (Bardhan, 1987).

Actually the interlinkage of credt takes place when the parties or any one party involved in interlocked credit transaction think that the delinking of credit with other factor markets would be infeasible or costly.

The occurrence of interlinkage of credit with other factor markets is not a new phenomenon in our rural credit circuit. The reference of interlinkage was made by Darling in 1925.

Interlocked transactions have been defined as "contracts made between the same pair of individuals relating change in more than one commodity or service, the contracts being interlocked in an essential way. In other words, contracts between a pair of individuals in two or more commodities that are interlocked by coincidence, i.e., contracts that could as well have taken place without change at different points in time and not necessarily between the same individuals, are not interlocked in this sense" (Braverman and Srinivasan, 1980 : 2).

Floro and Yotopoulos (1991) traced out five types of interlinkage. These are : I) the provision of intermediation services in re-lending and or procuring output; (ii) the sale of output to the lender, (iii) the purchase of inputs or lease of farm equipments from the lender ; (iv) the transfer of right over the usufruct of the land to the lender; and (v) the provision of labour services to the lender. The first three types are prevalent among trader-lenders while the last two are prevalent among farmer-lenders'.

An apt definition of interlinkage has been provided by Bell and Srinivasan. According to them, "An interlocked transaction is one in which the parties trade in atleast two markets on the condition that the terms of all trade between them are jointly determined" (Bell and Srinivasan, 1989:73). To speak simply, there is a "package or bundled deal" (Bell, 1988: 797) in which each element in the deal is connected to every other in an essential way.

The work of Bardhan and Rudra (1978) contributed much to the development of recent theoretical work. They took a survey of nearly 275 villages in West Bengal, Bihar and some of the eastern districts of Uttar Pradesh in 1975-76. The evidence strongly suggested that the landlord quite often gave production loan to the tenants. A number of empirical studies have been made in respect of the existence of interlocked contracts in the agrarian markets. Sarap (1986) conducted a field research in western Orissa and found a variety of interlocked transactions in respect of land, labour, inputs and output markets with credit, Saraf's observation was strongly supported by Kutty (1988) who found out the interlinkages in the transactions of coconut-growers in Kerala. In another micro-empirical study, Swaminathan collected primary data from Konur and Gokilapuram – two villages in the Madurai district of Tamil Nadu, and found out that" interlinkage with other markets, particularly the labour market, is, in many cases, an important feature of contract enforcement on loans" (Swaminathan 1991 : 177).

The existence of interlinkage of credit with other factor markets was reported in other countries also. Long who made study on Thai and Indian credit markets stressed on the role of interlinkage of credit with other factor markets. "The merchants who trade with farmers in Asia frequently combine the activities of retailer, moneylender and buyer of output" (Long, 1968:277). Floro Yotopoulos (1991) studied various aspects of informal credit markets by surveying fourteen villages in five Phillipine municipalities in 1984, and found that interest rates are lower for interlocked than for uninterlocked loans.

The interlocked transactions are not beneficial only, they are also highly exploitative in some cases. In an interlocked credit market the lender in the informal credit market enjoys a sort of monopoly position and thus charges high rate of interest, sometime it is 3 or 4 times more than as in the formal sector. In respect of credit interlocked with labour service it is seen that when labourers are given credit in exchange for labour services in future, even if the loan is free from interest, the labour-charges (wages) are much less than the prevailing market rate. Not only that, in some cases, the labourers are required to work for as many as 14 hours per day where the normal work-hour per day is 8-9 hours. Again in case of cultivator-borrower even if there is no underpricing of their crop by the lender-trader, the rate of interest charged are very high, leaving the borrower with no surplus, and forcing him to enter the credit-output contract once again . Further, they may be forced to buy inputs from their lenders only, even if the prices charged are high and the quality is poor. Thus, the exploitative aspects of an interlocked credit contract sometimes far exceeds the beneficial aspects. But so long as the institutional credit sector is not able enough to meet the credit need of the farmers, the informal sector with interlocked transaction is bound to continue in a dominant way

7.2 Causes of Informal Finance

Since pre-nationalisation period Government efforts have been made to drive out the informal moneylenders from rural credit market, but till today moneylenders are one of the most important source of rural credit. The conventional idea about rural credit market has drastically changed, now it is widely accepted that "credit transacted outside the banking circuit is quantitatively huge and qualitatively critical, especially in developing countries". (Floro and Yotopoulos, 1991, XV).

An investigation into our selected villages brought out the following prominent reasons for the existence of informal lending in the agricultural sector which are shown in the tabular format as under –

Table 7.1 - Frequency of the Responses to the Nature of the Causes for Informal Finance.

Category of farmers	Complicated paper work	Marketable collateral	Under valuation of colleteral	Lack of timely delivery of credit	Rigidity of repayment schedule	Harassment in obtaining loan	Total
Marginal farmers	27	6	-	7	-	16	56
Small farmers	19	4	1	3	5	9	41
Large farmers	2	-	9	1	3	-	15
Total	**48(42.86)**	**10(8.93)**	**10(8.93)**	**11(9.82)**	**8(7.14)**	**25(22.32)**	**112(100)**

Figures in the parentheses indicate percentage.

From the above Table 7.1It is evident that different categories of farmers have to go to the door of informal money lenders for credit needs, and the nature of the causes behind their going to the informal money lenders are not the same. They differ from category to category of farmers.

7.1.1 Complicated Paper Work

.Formal lending requires many official formalities and paper works for the delivery of credit. But as most of our farmers, particularly marginal and small farmers, are not literate, they are not able enough to make all papers ready for the purpose of having credit from formal sector. It is seen in reality that loan from informal sector is less complicated than that of the formal sector. Informal lenders require minimum papers, in some cases, no supporting papers, for delivery of credit and their service is very prompt and available round the clock. So, till they are the dominant player in the rural credit market.

7.2.2 Marketable Collateral

Marketable collateral means gold, land, silver, govt. papers etc. Non-marketable collateral means crop, labour, utensils, cattle etc. Formal sector does not deliver any loan without marketable collateral, whereas informal sector deliver credit against both marketable and non-marketable collateral. Since our marginal and small farmers do not possess sufficient marketable collateral for loan then money lenders who in some cases, deliver credit even without any collateral, they deliver credit on personalistic relation.

7.2.3. Undervaluation of Collateral

In formal sector collateral is undervalued. As the collateral is not vaslued as per prevailing market price, the probable loanee-farmers are nor paid loan as per their requirement of loan. As a result, their purpose is not fully served. They have to take loan from informal sector to satisfy their requirement of loan fully.

7.2.4. Lack of Timely Delivery of Loan

The loaning procedure in formal sector is very time-consumung. From application to the disbursement of laon takes a long time. The farmers apply for loan for crops in time but when it is sanctioned or disbursed, the time for crops for which loan was sought becomes over. But informal money lenders do not take much time to deliver credit to the former. They are very prompt and easy in this suspect.

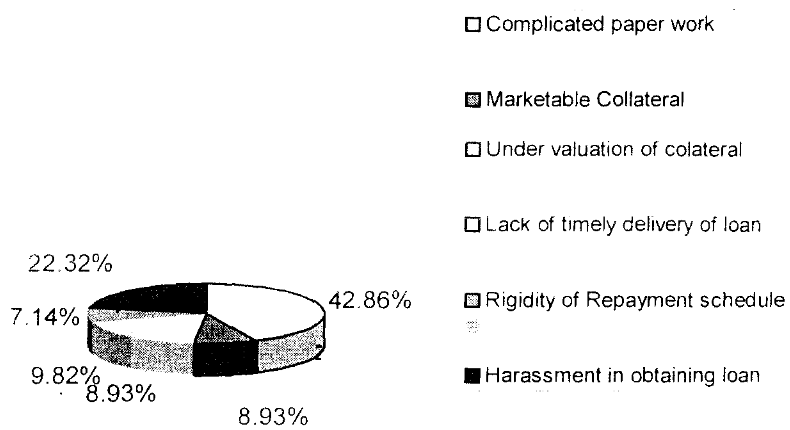
7.2.5 Rigidity of Repayment Schedule

The repayment schedule of loan of formal sector is very rigid. The loanee-farmers are not at liberty to repay loan as per their capacity or if any loanee wants to pay-off his loan before its maturity/scheduled time, extra charge or penalty for early closure of loan, is charged. Repayment is to be made as per the schedule of repayment framed by bank. But, in informal sector such rigidity is not seen. Farmers are at liberty to pay-off their loan any time they wish. There is no fixed amount of instalments of loan. Borrowers may pay any amount any time.

7.2.6 Harassment in Obtaining Loan : It is gathered from the loanee farmers , particularly marginal and small farmers as evident in the Table 7.1 that they have to go to the bank a couple of days for loan. The bankers, in many cases, do not tell them all about the paper formalities needed in getting loan. They tell the formalities in a piecemeal way. As a result, the farmers have to waste their several working days for this purpose. Sometimes, after repeated visit to the bank, the loan proposal is regretted. Thus they are harassed and become frustrated. For this reason, many marginal and small farmers have to approach for loan to informal lenders who are easily available to them.

The frequency of the causes (as evident in the Table 7.1) leading the farmers to the door of the informal money lenders in our surveyed villages would be more clear from the Chart given below –

Pie-Chart showing the frequency of causes for informal credit



It is obvious from the above chart that 48 borrower farmers out of 112 , i.e. 42.86 percent of the total loan cases , have assigned **'complicated paper work'** as the cause of their going to the door of informal money lenders to meet their credit need, whereas 10 borrower farmers out of 112. i.e. 8.93 percent of the total loan cases, have made **marketable collateral** responsible for their going to the informal lenders' house for the satisfaction of their credit need. The same number and percentage have made **undervaluation of collateral** responsible for informal lending. 11 borrower-farmers , i.e. 9.82 percent of the total loan cases , have made **lack of timely delivery of credit** as the cause to lead the farmers to informal lenders. **Rigidity of repayment schedule** has been assigned as the cause of informal lending by 8 borrower farmers i.e. 7.14 percent of the total borrower-farmers. Again, **harassment in obtaining loan** has also been made responsible to lead the farmers to informal lending. 25 borrowers i.e. 22.32 percent of the total borrower-farmers, have held this point responsible for leading the farmers to informal lenders to meet their (farmers) credit-need.

7.3 Nature of Informal Lenders and Their Relationship with Interlinkage of Credit.

The nature of informal lenders need to be clearly mentioned as the prevalence of informal credit in rural credit circuit still has a strong base in the rural areas under our study. Our study reveals that 31 percent (112 cases) of the total loan cases come from informal finance and out of 112 cases, 91 cases are found to have been interlocked with other agrarian factor markets.

The informal lenders who interlock their credit with other agrarian factor markets are mainly - big cultivators, traders and input-sellers. There is also village moneylenders who do not prefer to interlock their credit with other agrarian factor markets. The primary source of income of the village money lenders is lending. They lend money to the farmers at high rate of interest and generally take back money along with interest.

Big cultivators (locally known as jotedar) give credit mainly to the marginal and small farmers. They finance working capital to their tenants and/or other farmers or supply credit for consumption and in return, they secure for themselves an assured supply of labour during peak seasons. Wealthy farmers facing a constrained land mechanism – lending money and acquiring land thereof can be easily done if the lender is able to confiscate the land mortgaged to him by the borrower. They are primarily interested in farming operation but they carry on moneylending as a secondary source of income and also to create a monopoly power over other agrarian factor markets like labour, land and product.

Interlocking of credit can also be observed between the traders and the borrower-farmers. The trader-lenders primarily engage themselves in buying and selling of goods. They have to complete with each other for buying farmer's output in order to maximize their profit through further sale of output. Many times, traders have idle funds. The 'idle' fund leads the trader-lenders to increase the procurement of output and thus they enter into the credit market, and interlink credit with output.

There are also some traders who deal in farm inputs, they interlock their primary activity with lending money to the borrower-cultivators. Through lending money they can also anticipate a steady demand for their farm inputs.

Sometimes, it is observed that a trader deals in both farm input and output markets. He can maximise his earnings by linking credit with both input and output markets. Here a borrower-cultivator is made to buy inputs from the lender alone and is compelled to sell his output to the lender-alone.

Thus, various types of interlocking that could be found in our field survey are: the provision of labour services to the lender; the transfer of right of the land to the lender; the sale of output to the lender alone and the purchase of farm inputs from the lender.

Now, let us see how the different categories of farm households are attached to interlocked and non-interlocked credit transaction.

Table 7.2 : Extent of Interlocked Transactions in the Informal Credit Market.

Categories of Borrower-farmers	No. of households in the group	No. of borrowers with interlocked transactions	No. of borrowers with non interlocked transactions
(1)	(2)	(3)	(4)
Marginal farmers	56	49 (87.50)	7 (12.50)
Small farmers	41	33 (80.49)	8 (19.51)
Large farmers	15	9 (60.00)	6 (40.00)
Total :	112	91(81.25)	21(18.75)

Source : Field Survey

Notes :

1. Farmers have been categorized as follows :
   i) Marginal Farmers : Farmers having an amount of land upto 2.0 acres.
   ii) Small Farmers : Farmers having an amount of land upto 5.0 acres.
   iii) Large Farmers : Farmers having an amount of land above 5.0 acres.
2. Figures in parentheses are percentages of figures given in column 2.

It is clear from Table 7.2 that the different categories of farm households take credit with locked and non-locked transactions. The data have been taken from all six sample villages, one village from each block. It is evident from the Table 7.2 (column.3) that the majority of the borrowing farm households obtained credit through ihterlocked transactions (81.25 percent). The percentage of interlocked transactions falls with the increase in the size of landholding, and this result corroborates with many other studies (see, for instance Sarap, 1991 : 81) where the proportion of interlocked borrowers is higher among the households owning comparatively smaller amount of land. Our study also reveals the highest percentage of interlocked transactions among the marginal farmers (87.50 percent) and lowest percentage of interlocked transactions among the large farmers (60 percent).

Thus, it is evident from our field survey that interlocked credit transactions are not only "essentially a phenomenon confined to .... marginal and small farmers" (Sarap. 1991 : 81), it is also applicable in case of large farmers. The application of modern agro-technologies need huge cash outlays which make it necessary for the big farmers also to borrow; and as the existing institutional sources of credit is not sufficient to meet the credit need of the farming households, there is no option left but to turn to the informal sources of credit. As noted earlier, credit from this source is available to the cultivators as and when required with little or no formalities to be fulfilled.

Now, let us proceed to examine the preference of collaterals by the different categories of informal lenders.

Table 7.3 : Type of Informal Lenders and Collateral Preference in Percentage Irrespective of the Catetories of Households.

Type of Lenders	Total no. of loan cases	Percent of Distribution of Collateral Against Loan				
		Land	Product	Labour	Gold or silver	Total
Traders	10	-	70.00	-	30.00	100
Input-sellers	43	11.63	88.37	-	-	100
Large Farmers	42	19.05	-	80.95	-	100
Village money Lenders	12	-	16.67	-	83.33	100
Friends, Relatives and neighbours	5	80.00	-	-	20.00	100
Total	112	15.18(17)	41.96(47)	30.36(34)	12.50(14)	100

Source : Field Survey

Figures in the parenthesis indicate number of loan cases.

It is obvious from Table 7.3 that traders and big cultivators are more interested to accept non-marketable collateral like product and labour (43.40 percent and 30.40 percent respectively) while advancing loan to the farmers. It emerges from Table 7.3 that village moneylenders and friends and relatives have a tendency to advance loan to the farmers against deposit of marketable collaterals like gold and land. It is observed at the time of survey that in most cases friends and relatives do not seek any collateral from the borrower-farmers, but if they seek any collateral from the borrower-farmers, land is most preferred by them. In these cases, the lenders cultivate the mortgaged land (taken as collateral from the borrower-farmers) and possess its crops until the full amount of loan is repaid. Table 7.3 depicts that product has the highest demand as collateral (43.40 percent) and next to product it is labour being 30.40 percent. So, in informal agrarian credit circuit product and labour play important role to be interlocked with credit.

Let us see how different categories of households are involved in different types of credit transaction in villages.

Table 7.4 : Percentage of Households Involved in Different Types of Credit Transactions

Category of	Total no. of households in the group	No. of house holds involved in interlocked transaction	Type of Credit Interlinkage with farmers			
			Land	Labour	Output	Input
Marginal Farmers	56	49	-	58.93	28.57	-
Small Farmers	41	33	14.64	-	65.85	-
Large Farmers	15	9	-	-	40.00	20.00
Total	112	91(81.25 %)	5.36	29.46	43.75	2.68

Table 7.4 clearly reveals the different categories of interlocked transactions and the percentage of households involved in these transactions. From Table 7.4 it is evident that the most common type of interlocked transaction that the borrower-farmers like credit-output form of interlinkage. The informal money lenders (particularly traders and input-sellers) prefer to interlink credit with crop, as they can always be able to recover their due amount at the time of sale of crops. (as can be seen from Table 7.3) that the interlocking of credit with product market has the highest percentage (43.75 percent) and next (29.46 percent) is the credit-labour interlinkage.

Table 7.3 makes it clear that informal moneylender's preference for crop (output) as collateral is much higher than any other form of surety. Here the informal lenders have shown a greater foresight than the formal lending institutions, who still insist on land as surety, and hence they have not yet been able to be as popular among the farming households as informal finance.

7.4 Impact of Interlockimg of Credit on the Economy of Farming Households

The interlocking of credit with other agrarian factor markets deserves important impact on the economy of different farming households.

We begin with marginal farmers whose income from agricultural operations is not just enough to satisfy their consumption requirements. They do not have any surplus to continue their agricultural operations. Practically their situation becomes very pathetic if the harvest is not good. Borrowing is then the only way to meet their daily as well as production expenses. Since they are not in a position of having sufficient marketable collaterals, they have limited access to formal credit institutions where no loan is disbursed to the borrower-farmers without any marketable collateral. Naturally the borrower-farmers have to turn to the informal financers who readily accept the non-marketable or non-conventional collaterals like output or labour services the borrower-farmers afford to the informal lenders. In most cases marginal farmer's credit is interlocked with labour since the quantity of output from their own land is not as sufficient as may be available for sale after the required quantity of crops for their consumption. Besides, as their landholding is small they have to remain idle after the cultivation of their own land due to the lack of opportunities to work. Under such condition informal lender's credit-labour interlocked transaction ensures the marginal borrower- farmers to earn for consumption expenses.

The household economy of the small farmers is also influenced by the interlinkage of credit. As the small farmers do not have sufficient fund of their own after meeting all expenses , they have to go for credit to continue farming operation. Due to the non-availability of adequate supply of formal credit they have to turn to the door of informal lenders. In most cases it can be found that the small farmers prefer to interlock credit with output (Table 7.4). Very few small farmers happen to interlock credit with land as they do not have any access land for cultivation. Interlocking of credit with output is more acceptable to them as they find it a ready market for their product (output). Besides, they are not required to arrange for storage facilities of their own. So, interlinkage of credit with output is a blessing to them.

In case of large landowners, the increasing use of modern method of cultivation has increased their cost of production which needs huge cash outlays. To apply modern cultivation method borrowing is a necessity. In the absence of sufficient formal credit they have to turn to the informal lenders and commit them to sell their marketable output for sale to the lenders at harvest time. Here large landowners are benefited in several ways - no tension or risk to search for product market and no expenditure for storage facility and carriage of product to the market place. The large landowners do lending as secondary activity and interlink their lending with mainly two factor markets – labour and land (Table 7.3). Their interlinking of credit with labour ensures them assured supply of labour to their land at peak seasons when there is acute scarcity of labour. So, we see that their lending being interlocked with labour leads them to a position to smoothly continue their agricultural operation.

Again, sometimes, large landowners do lending business and interlink lending with land (Table 7.3). They lend against land to be mortgaged to them until the repayment of credit is fully made. Such mortgaged land being added to their own land expands the area of cultivation. Thus, they enjoy the benefit of economies of scale and thereby their household economy is improved.

7.5 Summary

The following main points emerge out of the present chapter

1. The informal lenders have a strong hold in the district of our study as till date. Still 31.11 percent (112 out of 360 cases) of the total loan cases come from informal sector of credit in the villages of our study.

2. The types of interlinkage of credit found in our study area are : the provision of labour services to the lender, the transfer of right of the land to the lender; the sale of output to the lender alone and the purchase of farm inputs from the lender.

3. 81.25 percent of the total informal credit cases are interlocked with other factor markets .

4. The number of interlocked transactions decreases with the size of land holding. The interlocked transactions are 87.50 percent, 80.49 percent and 60 percent for marginal farmers, small farmers and large farmers respectively.

5. As regards the collateral preference against interlocked credit transactions it could be gathered from our field survey that collateral preference differs from lender to lender. Traders and input-sellers prefer product as collateral whereas large farmers, village moneylenders and friends and relatives and neighbours prefer labour, gold or silver and land respectively.
6. In the informal rural credit market the input-sellers are the most influential and have the largest share in informal agricultural credit market.
7. The household economy of all categories of borrower-farmers – marginal, small and large, in the study area, is benefited through interlocked credit transactions. Hence, interlinkage of different forms of agrarian market appeared to be beneficial to both lender and borrower-farmers.