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メタデータ	言語: 出版者: 琉球大学法文学部 公開日: 2017-02-06 キーワード (Ja): キーワード (En): 作成者: Kakazu, Hiroshi, 嘉数, 啓 メールアドレス: 所属:
URL	https://doi.org/10.24564/0002008508

Marketing Distortions and the Private Moneylenders in the Underdeveloped Rural Areas

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I

Historically, the development of market economy proceeds from the commodity market to the factor market. Of the commodity market, the perishable products market develops first then the agricultural staples market, manufactured consumers' goods market and the capital goods market follow in order [33, pp. 519-541]. The development of the commodity exchange markets largely depends upon the nature and degree of the division of labour which in turn depends upon the size of markets and the technological development as was originally conceived by Adam Smith:

As it is the power of exchanging that gives occasion to the division of labour, so the extent of this division must always be limited by the extent of that power, or, in other words, by the extent of the market. When the market is very small, no person can have any encouragement to dedicate himself entirely to one employment, for want of the power to exchange all that surplus part of the produce of his own labour, which is over and above his own consumption for such parts of the produce of other men's labour as he has occasion for [31, p. 17].

Since the market demands for the factors of production are derived from the market demands for the commodities, the developments of the factor market proceed in accordance with the developments of the commodity

This is Part II of my paper "Market Distortions and Economic Development" which was originally written while I was a visiting researcher at the London School of Economics and Political Science during 1974-75. Part I of the paper was published in the *Developing Economies* (XIV-2, June 1976).

I would like to thank Professor Hla Myint for his valuable comments on this paper.

market: that is to say, the labour market develops first corresponding to the earlier developments of labour intensive commodities such as perishable products and agricultural staples, then the financial markets¹ develop later in accordance with the emergence of the capital intensive goods. In the underdeveloped countries, the financial markets are not only the least developed markets, but also they are the most segmented markets of all exchange systems (cf. [20]). The segmentation of the financial markets or 'financial dualism' was first brought into the underdeveloped countries through the unbalanced development of the export sector, viz. mine and plantation, in relation to the indigeneous agricultural sector, and in the later stage, the dualism was accentuated by the deliberate industrialization of the underdeveloped countries:

The peasants, the small traders and craftsmen in the traditional sector have always suffered from a shortage of capital and high rates of interest because of the much higher risks and costs of lending money on a retail basis to these classes of small borrower. But now, this handicap has been aggravated by government policies to promote domestic industrialization. These policies have the effect of providing the scarce capital and foreign exchange resources and public economic services on excessively favourable terms to the larger economic units in the modern sector and on excessively unfavourable terms to the small economic unit in the traditional sector [22, p. 64].

Thus the development of the financial markets of the underdeveloped countries should be analysed through the historical interactions between the spontaneous market forces and the artificial economic forces of government. In this investigation, however, we are mainly concerned about the financial activities of the private moneylenders of the underdeveloped rural areas under the condition of the spontaneous market distortions.² There

¹ The term "financial markets" used here contains both capital and money markets.

² For the definitions of the various types of distortions, see [20, pp. 109-131].

are three main reasons to claim that the financial development in rural peasant economy shall be best analysed through the financial activities of the private village moneylenders. First, the private moneylenders are the major source of the credits to the subsistence agricultural sector which is still the most important source of employment and income for many underdeveloped countries.³ U Tun Wai estimated the relative importance of the unorganized money markets⁴ by comparing the value of rural indebtedness outstanding with the claims of all private banking institutions and concluded that 'it is significant that agricultural or rural indebtedness exceeds the claims of the banking system on the private sector of the economy, a fact which suggests that in these countries the unorganized money markets are more important than the organized.' [36, p. 84] Of the unorganized money markets, the noninstitutional sources dominate the agricultural credits (see Table 1).

TABLE 1 : SOURCES OF AGRICULTURAL CREDIT

(In per cent of total)

	Ceylon (Fiscal 1950-51)	India (Fiscal 1951-52)	Pakistan (1951)	Thailand (Fiscal 1952-53)
Institutional sources	46	7	16	16
Commercial banks	8	1	—	—
Cooperatives	7	3	13	16
Government and government-owned institutions	31	3	3	1
Other				
Noninstitutional sources	54	93	84	84
Professional moneylenders	50	70	1	20
Traders and shopkeepers		6	3	17
Landlords	4	2	17	1
Relatives, friends and others		16	63	46

Source: U Tan Wai, 'Interest Rates Outside the Organized Money Markets of Underdeveloped Countries,' *IMF Staff Papers*, Vol. VI (November, 1959), p. 87.

³ In India and Pakistan, for example, agriculture employs more than 70 per cent of the total labour force and contributes nearly 50 per cent of their national products (Peason [26, pp. 30-32 and Table 3, pp. 362-363]).

⁴ According to U Tun Wai, the unorganized money markets include agricultural banks and cooperatives and the noninstitutional sources of credits, i.e., professional moneylenders, landlords, traders and shopkeepers relatives, and friends (Wai [36, p. 86]).

For India, Pakistan and Thailand, the noninstitutional moneylenders accounted for more than 80 per cent of the total agricultural loans. Ceylon's low percentage of noninstitutional credit reflects its highly developed financial structure compared with that of most underdeveloped countries together with some statistical error [36, p. 86]. Of the noninstitutional sources, professional moneylenders, relatives and friends are the most important suppliers of the agricultural credits.

Second, the activities of the private moneylenders are considered to be free from the artificial restrictions such as government licensing and usury legislation and monopoly power; that is to say, the operations of the moneylenders are subject to the free play of market demand and supply forces under the condition of autonomous distortions [36, pp. 114-116] [23, p. 11]. Thus the analysis of the private moneylenders' activities will offer valuable information with respect to the degree of development of the financial markets in the underdeveloped countries.

Third, if we know the role of private moneylenders in allocating the financial resources, we can determine the appropriate monetary policies to develop the viable financial markets in the segmented economy.

We shall first discuss the origin and sources of finance of the private moneylenders, and then the activities of the various types of moneylenders are analysed.

II

The private moneylenders are not particularly unique to the underdeveloped countries. They can also be found in some consumer and agricultural credit markets in the advanced countries [36, p. 86]. In the underdeveloped peasant economy, however, the moneylenders are not only the dominant sources of agricultural credit but it is well known that they also perform other important roles such as retailers, traders, landlords and producers:

... the money-lenders, usually known as *sowcar*, *banica*, *makajan*, may be classified into professional moneylenders, either rural or urban, including itinerant money-

lenders such as land-owners, agriculturists, merchants, traders, pleaders, pensioners, jobbers and sardars of labourers, priests and widows, who pursue other activities but lend out their surplus funds [24, p. 51].

This multiplicity of small creditors is what typifies the moneylending activities of the peasant society [38, pp. 148-163]. The multiple roles of the moneylenders stem from the very nature of underdevelopment of the peasant economy where the exchange system is not well developed to the extent that it guarantees an economic unit to specialize in a specific economic activity [cf [2, pp. 741-755] [4, pp. 98-106] [3, pp. 3-277]]. Thus the degree of multiplicity of creditors depends upon the degree of development of the financial markets; that is to say, the more the market develops, the more specialization and therefore the less multiplicity can be seen. Generally speaking, the professional moneylenders coexist, both in the organized and unorganized money markets, with the small trader-cum-moneylenders, landlord-cum-moneylender, and trader-cum-landlord-cum-moneylenders. This diversified nature of the moneylending activities, which differ from country to country and from region to region, defies any straightforward application of the conventional macroeconomic theory to the problem of the financial markets of the agrarian economy. The occasional conflicting results of the studies with respect to the behavior of village moneylenders seem to stem from their inadequate identification of the market conditions under which the various types of moneylenders operate. This aspect will be fully discussed later.

Reflecting the multiple nature of the moneylenders' activities, their financial sources are also diversified. For the indigenous village moneylenders, however, regardless of the type of moneylender, the initial sources for loans will come from the family savings:

At any moment loans are offered by families whose receipts from production and trade (and from interest payments on past loans) have exceeded, over the recent past, their purchases of commodities to be consumed or added to their own stock of means of production; that

is to say, by families whose saving exceeds their own investment [29, p. 4].

The families who can generate the surplus will be the ones who can exercise the economic and noneconomic powers over other families through the regular trading. As the internal trade increases the families who have superior economic opportunities and information over others will also act as middlemen or as village shopkeepers [16, pp. 25-41]. In the peasant export economies such as Malaya, Ceylon, Burma, Thailand and Ghana, these village middlemen have acted as the intermediate distributors of imported consumer goods as well as the moneylenders and the collectors of the peasant products for large foreign-owned trading firms.

In most peasant export economies, the middlemen often a long chain of intermediaries, culminate in a few large-export-import firms, each buying a large proportion of the total output of the peasants [22, p. 37].

The credits are also extended in a long chain fashion, starting from large trading-cum-financing firms down to the small village retailer-cum-moneylenders:

In Sarawak, indeed, there appears to be a regular 'ladder' of credit accounts of this kind leading right up from the small rural bazaars to the importers in Kuching, who themselves may be in a somewhat similar relationship with bigger firms in Singapore [38, p. 154].

In most of the African economies, two important sources of funds were advances of money or goods by foreign traders and the savings of families and their relatives. The first form of finance, however, has become less readily available now due to the gradual displacement of foreign and domestic trading firms by large state corporations [19, p. 246]. The short-term commercial credit was also raised in West Africa by means of so-called 'gold coasting' under which 'an established customer of an importing house buys standard lines of merchandise on credit at the beginning of

the month, promptly sells these (if necessary, even at a loss), and uses the proceeds to finance internal trade or money lending' [5, p. 507]. Thus in many export oriented underdeveloped countries, the peasant agriculturists receive loans from the small village moneylender-cum-retailers who in turn receive the credit from wholesalers and buying agents who also obtained finance from large import-export firms which have credit connections with the foreign commercial banks.

In India, except a few districts, village moneylenders as a whole obtained practically no significant finance from the indigenous and foreign commercial banks [27, p. 507].

In Southeast Asia such as Ceylon, Burma, Malaya, Indo-China, and Thailand, the foreign moneylenders, mainly the Chettiars of India⁵ played a very important role in linking the local moneylenders with those banks prior to the great depression:

A report to the Ceylon Banking Commission in 1934 states that the exchange banks in Ceylon used to make large advances to the Chettiars in Ceylon totaling about Rs 20 million a year, and that the Imperial Bank of India advanced an additional Rs 20 million each year before the depression. Since the total assets (mostly loans) of the Chettiars in Ceylon before the depression were about Rs 150 million they obtained about one third of their working capital from commercial bank sources [36, p. 95].

The rest of the Chettiars' lending resources in Ceylon came from the Chettiars' own capital and the loans from friends and relatives.⁶ In the

⁵ These Chettiars are always identified as the Natukattai Chettiars who hailed from the South Indian district of Chettinard. For the Chettiars moneylending activities see ([37, pp. 43-49] [15, pp. 195-200]).

⁶ The Chettiar's total capital for the pre-depression year of 1925 was as follows:

	(RS million)
Own capital	85
Loans from friends and relatives	40
Short-term loans from the banks	25
	150

Source: Gunasekera [15, p. 198].

case of Burma, the Chettiars borrowings from the Madras and Burma commercial banks were negligible accounting for less than 1 per cen of the total resources. The Chettiars financed directly the local agriculturists, but they also made loans to the village moneylenders, and retailers and landlords who in turn extended credit to the farmers. In Burma, a large portion of the Chettiars lending resources were augmented by the deposits made in Madras district of India and also deposits made by non-Chettiars in Burma such as Chinese traders, Marwars and Multania as is shown in the following consolidated balance sheet of the Chettiars at the end of 1929 :

TABLE 2 : CONSOLIDATED BALANCE SHEET OF CHETTIARS
IN BURMA 1929

(In lakhs of Rupees)

<i>Liabilities</i>		<i>Assets</i>	
Proprietors' and Relatives'		Cash in hand, notes dis-	
Capital	55,00	counted & advances made	65,20
Deposits in Madras	20		
Deposits in Burma	5,70		
Advances from Madras			
Banks	1,30		
Advances from Burma			
Banks	<u>3,00</u>		
	Total		Total
	<u>65,20</u>		<u>65,20</u>

Source : U Tun Wai, *Burma's Currency and Credit*, p. 45.

The Chettiars were mainly engaged in the moneylending business prior to the depression years during which they were forced to foreclose on the mortgages and became owners of land and industrial property because many farmers could not afford to pay interest or amortization on the loans. The Chettiars in turn had great difficulty to honour their debts to the commercial banks. Thus 'the close connection between the two markets in Southeast Asia afforded by moneylenders borrowing from commercial banks was disrupted by the depression; and it has not been in evidence in postwar years.' [36, p. 96].

The village moneylenders also obtained the loanable funds from the co-operative credit societies, agricultural banks and other government financial

institutions though their importance as the sources of funds differ to a great extent by the countries. In Latin America and the Middle Eastern countries, the cooperative credit societies are less important source of funds to the moneylenders than of many of the Asian countries but the government financial institutions are an important source in the former than the latter [36, pp. 88-93].

III

As we have discussed in the previous section, the moneylenders in the underdeveloped peasant society perform a variety of economic activities. It is hardly possible to distinguish the moneylender from the trader, landlord and other occupations. Thus, it is essential to analyse the money-lending activities in the context of the multiple roles of the moneylenders. Frequently, the practices of the moneylenders were condemned, on the one hand, as unscrupulous usurers, land-grabbers, and blood-suckers. On the other hand, they were commended as the friends of the peasants and the benevolent financial helpers in times of need [24, p. 55]. These conflicting views seem to stem largely from the researchers' failure to grasp the moneylenders in the light of their entire economic activities under the different market conditions. In this section, we shall present the hypothetical models of money-lending practices by classifying the moneylender into four major types according to his major occupation: (1) professional moneylender, (2) merchant-moneylender, (3) landlord-merchant-moneylender and (4) landlord-moneylender. The historical development of moneylending may proceed in the reverse order, i. e., from type 4 to type 1.

1. Professional Moneylender :

The professional money lenders are those who specialise in the money lending business such as the Chettairs, Chinese moneylenders and the indigenous village moneylenders. The professional moneylenders in the villages are different from the indigenous bankers in the sense that they usually do not receive deposits which is an essential function of the banking business. 'Some money-lenders may now and then use funds temporarily deposited with them for safe custody by their clients, but this business is

too uncertain and too small to justify their claim to the title of bankers' [24, p. 51].

Most of the loans made by the professional village moneylenders are small, unsecured and for the consumption purpose. But when they make the large and long-term loans for the agricultural investments, they secure mortgages such as land, houses, or ornaments [24, p. 51]. In this model, we shall assume that the moneylenders are trying to maximize the expected returns on their loanable funds. We shall distinguish the moneylenders such as the Chettiers who can obtain the funds from outside the village economy from the ones who rely totally upon their own funds for loans such as indigenous moneylenders.

In the case of the Chettiers, who can reach the outside banking system for additional loanable funds, their expected returns of the loans will be determined mainly by (1) the opportunity cost of the funds, (2) the risks they will assign on the individual borrowers, and (3) the cost of obtaining the additional funds. These factors, particularly the opportunity cost and risks of the loanable funds, depend upon the market information which is available to the moneylenders. The economic principle tells us that if both the opportunity cost and the risks are high, the interest rate charged by the moneylender should also be high. Since each moneylender in the segmented village economy faces different opportunity cost and risks, the interest rates charged by them will also differ significantly depending upon the particular market conditions. The wide range of variations in the interest rate, sometimes reported from 10 per cent to as high as 360 per cent per annum [36, p. 99], will be largely explained by the variations of risks and opportunity costs which can be partly translated into the cost of obtaining information:

Thus, in referring to moneylending in the Middle East and Asia, the summary report of the International Conference on Agricultural and Cooperative Credit states that 'the exorbitant rates of interest charged by the village moneylenders are explained, if not justified, by the high risks and high costs involved in supplying credit in

small amounts [17, p. 69].

In spite of the U Tan Wai's conclusion that 'the exceptionally high rates of interest in the unorganized money market are due to excessive demand rather than to a premium to insure lenders against the risk of default,' the limited supply of funds associated with the high lending risks seems to be more important in determining the interest rate in the peasant society where the scarce funds are rationed through the personal tie according to the risk of individual borrower and furthermore, the moneylenders are little concerned about how the funds are utilized by the borrower [24, p. 52]. Thus we may reasonably assume that 'the high rates of in rural areas are exclusively lenders' rates' [10, p. 63] not because of the monopoly element as is suggested by Chandavarker [10, p. 20] but because of the high risk rising from the autonomous distortions which prevent the potential competitors breaking into the local money market even if the entry into the market is free.

The Chettiars case of moneylenders who can obtain additional funds from outside sources is illustrated in Figure 1.

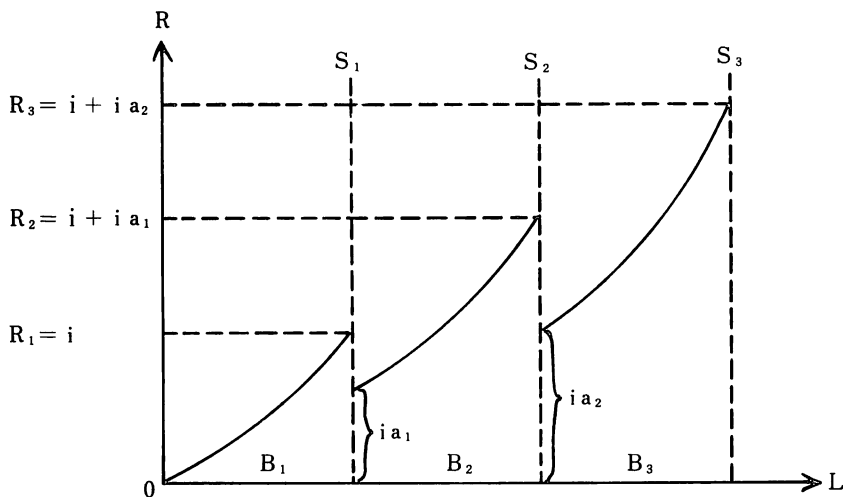


FIGURE 1

Assuming there is no artificial distortion and that the first borrower (B_1) is riskless, the moneylenders will charge B_1 the R_1 rate of interest which is determined by the opportunity cost of using funds, or the moneylender's real costs in obtaining funds from the organized money markets. It is also assumed that the opportunity cost will increase as the demand for funds increases, thus the supply curves of funds have positive slopes. The demand for the funds from the second borrower (B_2) with an a_1 element of risk (autonomous distortion), will be met by obtaining additional funds from the outside sources. The rate of interest R_2 is obviously the opportunity cost (i) + the risk element (ia_1). With the same reasoning, the riskiest borrower in Figure 1 (B_3) must bear the highest interest rate ($R_3 = i_1 + ia_2$). In Figure 1, the total funds (L) are allocated according to the risk of the individual borrower so that the moneylender's expected return on the loans are maximized. Thus the actual supply curve of the loanable funds is segmented by the risk element of the autonomous distortions. The relationships between the autonomous distortions (a) and the rates of interest (R) are depicted in Figure 2.

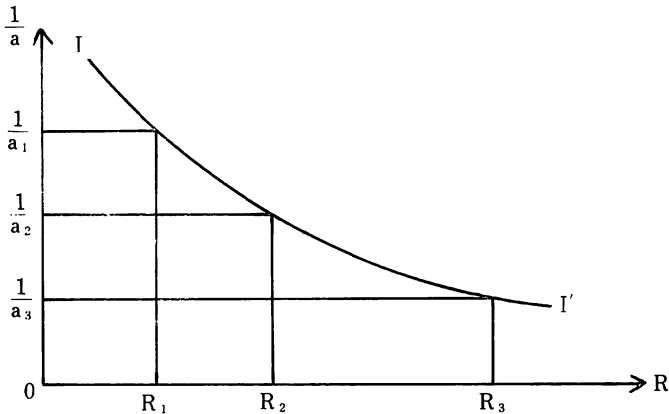


FIGURE 2

⁷ In the underdeveloped countries where the government bond markets are well developed such as India, the opportunity cost of the moneylenders' funds may be fairly approximated to the yields on the government bonds which are considered to be risk free. See [10, p. 69].

The risk consciousness of the Chettiers will be stronger than the indigenous moneylenders due to the fact that the former is also obliged to honour their debts to the commercial banks [36, p. 96].

In the case of the indigenous moneylender whose lending resources are solely supplied by his own savings, the fund supply curve will be perfectly inelastic; thus the moneylender will allocate the funds among the borrowers in such a way that his expected return from each borrower will be equalized as is shown in Figure 3.

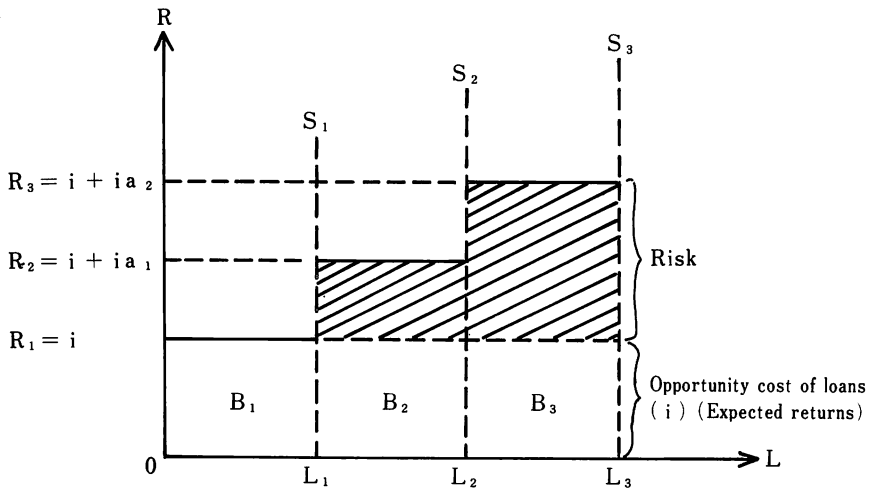


FIGURE 3

We again assume that B_1 borrower is risk free; thus he bears the lowest interest rate (R_1). The riskiest borrower (B_3) must bear the highest rate corresponding to the highest risk. The only difference from Figure 1 is its perfectly inelastic supply curve reflecting the unavailability of the outside sources of fund supply. The interest rates charged by the indigenous moneylenders may be lower than the Chettiers' rates due to the lower opportunity cost of their fund and their more intimate personal relationships with the local borrowers than the Chettiers. The indigenous moneylenders seem to be more concerned about the punctual payment of the interest than the safety of the principal, because 'it is their chief source of income.' [24, p. 45].

In the model, we have implicitly assumed that the term and the amount of loans are the same for all borrowers regardless of the nature of demand. It is well-documented that the longer the term and the larger the amount of loans, the lower the interest rate [36, p. 104] [24, p. 55]. The principle explanation of this practice can be found in the fact that large and long-term loans are usually secured by less risky collateral such as agricultural land, ornaments, and other property than the collateral used for small and short-term loans, namely promisory notes, commodities and livestock. It is also worth while to note that 'loans given without security carry much higher rates, with a maximum of 300 per cent. The Pathan, Kabuli and Rohilla moneylenders charge from 75 to 360 per cent as they run a great risk of losing money' [24, p. 55].

The higher interest rates for the small short-term loans may also be due to (1) the higher administrative costs in disbursing and collecting the loans that the large and long-term loans, and (2) the higher opportunity cost of the short-term loans than the longer-term which will arise from 'the possibility of having funds lie idle between repayments and new loans' [36, p. 104].

2. The Merchant-Moneylender :

As we have already discussed, it is common in many underdeveloped peasant economies that the local merchants or middlemen also act as the moneylenders. These merchant-moneylenders are typically observed in the peasant export economies such as West Africa and Malaysia where the merchants act as middlemen between the cash crop producing farmers and the wholesaler dealers of large export-import firms [38, pp. 148-165]. The merchant-moneylenders usually make advances to the peasant farmers on condition that the latter's cash crops should be sold to them. They use the credit to the farmers as an important means to secure the steady flow of the cash crops to them. 'Such moneylenders are less exacting in their terms, as the sale of crops to or through them gives them substantial profits' [24, p. 53]. In the case of Malaysia, however, 'the Chinese middlemen-retailers do their best to keep the Melanaw (a peasant farmer in Sarawork) in the red so that they can continually be reminded of their debts and urged to bring in more sago under threat of having their sup-

pliers of credit cut off' [38, pp. 152-153. parenthesis is mine].

The well-known practice of the merchant-moneylenders, which is called *Shayl* in Northern Sudan and *Sabape* in Burma, is the form of advances in money or kind against the security of standing crops: [40, p. 141].

The essence of the practice is the extraction of an exorbitant rate of interest by having the commodity in which a loan is repaid valued at a price much lower than that which is likely to prevail at harvest time. The lender thus reaps the benefit not only of the usual high rate of interest but also of the difference between the two prices [36, p. 99].

We do not know how much per cent of the total loans made by the moneylenders are secured by standing crops in these countries. In India, however, it is reported that 'only 12 per cent of the village moneylenders answering the relevant question said that they advanced loans against standing crops' [27, p. 470]. The 'malpractice' of the merchant-moneylender will be strengthened if he is in a position to exercise the monopolistic lending power coupled with the monopsonistic purchasing power over the number of small farmers as can be illustrated in Figure 4.

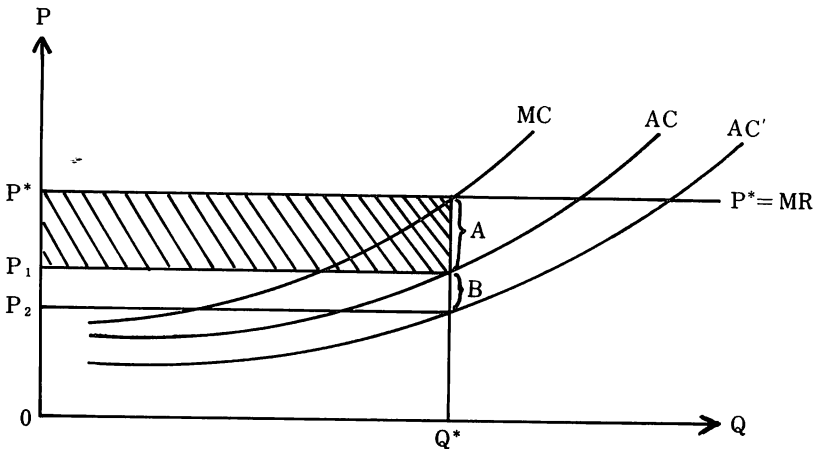


FIGURE 4

Assuming the local merchant-moneylender (resaler of the cash crop) can not influence the world price (P^* is given), he will purchase the crop, or supervise and advise the cultivator to produce, up to the point where marginal cost (MC) of the moneylender equals his marginal revenue (MR). The merchant-moneylender will buy the crop from the farmer, who does not possess any monopolistic power, at the price of P_2 by subtracting the interest rate (B) from the farmer's supply price (P_1) or average cost (AC) which includes the interest cost. Then he will sell the crop at the prevailing price (P^*) to maximize his sales gain (A). Intention of the merchant-moneylender to force the cultivators into permanent debts by discounting the farmers' supply price below P_2 , which is a subsistence price level for farmers, will not serve for his best interest as he tries to maximize his long-run profits. The act to reduce the purchasing price below the subsistence level will simply increase his risk as a merchant-cum-moneylender, because the farmers will not only cease to produce the crop, but also they cannot afford to repay their debts.

Nominal interest is kept in these conditions, at fantastic levels. But this is mainly a device to keep the peasants in debt. The actual payments exacted cannot exceed the margin between subsistence and rent [28, p. 270].

Though the loans against standing crops, or 'forward sales' have been cited as clear evidence of exploitation, Gilbert suggests that

farmers engaging in forward sales were found not necessarily to be needy. Some farmers found it advantageous to have continuing relationships with assembling wholesalers, in turn, benefited from having assured sources of supplies. One trader interviewed said that he did not make forward purchases from needy farmers because he regarded them as bad risks [13, p. 241].

The cumulated rural debts reported in many surveys [36, pp. 83-85] [24, pp. 46-49] seem to stem largely from the adverse farming conditions caused by bad weather, overpopulation, inadequate farm policies as well as

from the vagaries of crop prices which are beyond the control of the small merchant-cum-moneylenders. It should also be noted that the high rate of time preference of the farmers, due to the rapid seasonal changes in the prices of the crops, has resulted in the higher rates of interest because of the storage costs and the higher resale risks of the merchant-moneylenders [25, p. 10].

3. The Landlord-Moneylenders :

The landlords are also important suppliers of credit to the village farmers. Generally speaking, they advance short-term consumption loans to the small cultivators against the security of immovable property, bullion, and ornaments and crops [27, pp. 425-455]. The landlord-moneylenders have been more frequently accused in the literature than other types of moneylenders because of their alleged double role as the exploitative semi-feudal landowners and usurious moneylenders :

The landlord money-lenders especially are the most dangerous, as they get a double hold over their tenant-borrowers, who have to pay both rent and interest, are apt to fall into arrears of one of two and are liable to have their crops seized and to be ejected from the land. [24, p. 53].

After conducting a survey on the relationships between the landlord-moneylenders and the landless sharecroppers known as *kishans* in West Bengal villages, Bhaduri has to say this :

The *kishan* is almost always heavily indebted. A substantial portion of the *kishan's* legal share of the harvest is taken away immediately after the harvest as repayment of past debt with interest, thus reducing his actual available balance of the harvest well below his legal share of the harvest. This does not usually leave the *kishan* with enough food to survive from this harvest to the next and the serious problem of survival from harvest to harvest can only be overcome by borrowing for consumption [6, p. 122].

The causes of the often-cited tragic plight of the small landless sharecroppers can largely be explained through our consistent hypothesis that the landlord-moneylender tries to maximize his long-run profit under the risky market conditions. The landlord-moneylender can be considered to possess the stronger bargaining power over the small tenant-borrowers than any other type of moneylender because of his monopolistic position as the supplier of land in a village community. The landlord's monopolistic power will be stronger, the greater the peasant population density and the lesser the amount of land being brought into cultivation. It is well known, particularly after 1930, in the land scarce and overpopulated peasant economies of Southeast Asia, that the landlords allocate the land among the cultivators on the basis of competition and the solvency of the tenants. Thus 'the extent of tenancy and the degree of competition among prospective tenants for the right to farm land determined the share of the crop taken in rent' [30, p. 33]. Because of the vigorous competition among the peasants to cultivate the given land, the rent is pushed up as high as to 60 per cent of the annual produce [30, p. 31]. In addition to the rent, the tenants are expected to provide the landlord free labour when the occasion demands and various gifts during festive periods [30, pp. 30-31]. The plight of the cultivators is usually intensified by the existence of share-rent contracts under which the tenants are required to pay the landlord a specified proportion of the farmers' produce.⁸ The landlord's preference of share-rent contracts to fixed rent contracts is that the former method not only contains the risk sharing scheme with the tenants when the farming subjects to the fluctuations in weather and prices, but also it frees the landlord from supervising the cultivation which is required in the case of the latter method [25, p. 10]. The landlords are usually product rather than production oriented, thus they do not much concern about improving the production method [30, p. 31].

On the other hand, in *Wealth of Nations*, Adam Smith already pointed out that the tenant under the share-rent contracts would be extremely reluctant to use his own capital in an efficient way:

⁸ According to Gale Johnson, the crop-share lease is the commonest share lease in the peasant agriculture. see [18, pp. 111-123].

It could never, however, be to the interest of this last species of cultivator to lay out, in the further improvement of the land, any part of the little stock which they might save from their own share of the produce, because the lord, who laid out nothing, was to get one-half of whatever it produced. The tithe, which is but a tenth of the produce, is found to be a very great hindrance to improvement [31, p. 366].

Newbery has also pointed out that 'share tenancies share risk, but provide an incentive for the tenant to under-supply his labour input,...' [25, p. 11] thereby leading to an inefficient use of the resources [11, p. 30].

The landlord will also act as the monopolistic supplier of credit to the small tenants not because the landlord-moneylender does not compete with other village moneylenders in the money markets but because the tenant farmers usually can not find other alternative sources of loans except the landlord due to their lack of suitable collaterals and credit-worthiness. Thus, the only choice left for the tenants is either to borrow continuously from the landlord to sustain the current level of consumption or to abandon entirely their village life because they just can not find an alternative source of finance to sustain even their minimum subsistence level.

The interest rates charged by the landlord-moneylenders are ambiguous because the rates under the share-rent contracts may contain the component of interest rate. The monopoly profits can be obtained either by increasing the share rent, or by increasing the rates of interest on loans. The actual interest rates charged by landlord-moneylenders varies from nil to 35 per cent [27, pp. 435-455] which are considerably lower than some studies suggest:

The own (landowner) rate of interest charged on consumption-loans was typically around 50-100%. The lowest that I came across was 25% and the highest 200%. This rate is not annual, but over a time-period of about 4 months [6, p. 123] [30, p. 24].

A large portion of the nil interest rate reported in the *All-Indian Credit Survey* is probably due to (1) the tenants could not pay the interests on their loans, (2) interest payments were included in the rents, or (3) the interests were collected in the form of farmers' produce or by reducing the landlord's purchasing price of the produce. The last form of charging interest is common when the landlord-moneylender is also a merchant.

4. Landlord-Merchant-Moneylender :

The most complicated moneylending operation in the peasant economy can be found in the type of landlord-cum-merchant-cum-moneylender (or the triple-role moneylender). The operation of this type of moneylender differs in very important ways from the others. First, the triple-role moneylender possesses and can exercise the potential monopoly and monopsony powers in the three markets, viz. land lease market, product market and money market. The greater the segmentation in the peasant economy, the greater socio-economic power of the triple-role moneylender over the tenant-producer-borrowers may be expected :

When a landlord combines the functions of a leaser and a merchant, the terms of the lease are not only themselves quite stringent (given his position *vis-a-vis* the tenants in the lease market) but quite often include stipulations as to what crops the tenant ought to grow and the mode as well as terms of payment of rent. For instance, he can dictate the rent to be paid in kind and the time of payment. Thus the tenant's involvement in the lease market restricts his freedom to exercise choice in production (in terms of crops to be grown) and in the output market (to whom and when to sell the product) [7, p. 4].

In the case of a Malayan rubber peasant economy, the most important source of power of the triple-role moneylender seems to come from his activities as a moneylender :

As long as the smallholder merely sells to the dealer,

but does not borrow from him or buy on credit at his store the smallholder is virtually free to change buyers at will, provided there is no price or market-sharing collusion among the dealers [39, pp. 34-35].

Second, the operation of the triple-role moneylender has its economic justification in the small peasant economy where the size of the volume of transactions or the size of the markets are so small that his operation is economically feasible only by combining the three functions [39, p. 36]. It is well-documented that the administrative costs and risks involved in the small and short-term loans, which are typically made by the triple-role moneylender, are a good deal higher than the large and long-term loans in any economy [8, p. 154]. Thus, combining the triple activities, the moneylender can obtain both the economy of scale and the accurate inside information on the borrowers which will put him in a powerful position to reduce the administrative costs and risks.

Third, because of the multiple activities of the moneylender, the real loss incurred in one market, due to, for instance, a sudden change in purchased produce or inflation, will be more easily shifted back on the tenant-borrowers than the other types of moneylenders.

The interest rates charged by the triple-role moneylender are the most ambiguous of all types of moneylenders. The ambiguity stems from the difficulty to distinguish the pure interest rates from the monopsony profits and rents. If the moneylender possesses monopoly or monopsony power over the tenant-borrowers, the former squeezes the all surplus over the latter's subsistence funds by the name of interests, rents or profits:

If the lender is a monopolist, he can, in establishing the rate, force the borrower on to his all-or-nothing demand curve thus capturing all the surplus; with profits from the credit transaction already maximized there is nothing further to be gained from a tied sale [21, p. 287].

⁹ It is reported that the interest rates on short-term consumer loans are often higher than the comparable loan rates in the organized sector of the underdeveloped countries averaging 24 per cent per annum. See [32].

The usual practice of the the triple-role moneylender, who are locally known as the *jotedar* in West Bengal villages of India, is to give loans to the peasant farmers sometime before the harvest during which the current prices of paddy are at their highest and demand the loan repaymant in kind right after the harvest time when the prices are at their lowest. Thus the farmers must buy the produce from the triple-role moneylender at its highest seasonal price and sell him at the lowest seasonal price. 'All that the *jotedar*...does, is to make a forward contract of repayment in kind calculated at current prices' [6, p. 123]. If we regard the difference of the two prices as interest, this kind of 'malpractice' often implies an exorbitant rate of interest:

the price of a 'manund' of rice (about 82 pounds) just after the harvest was Rupees 20 in the local village market which rose to Rupees 60 in about three months' time when this particular peasant borrowed. His *jotedar* used current market prices to fix repayment in kind, so that for each 'manund' of rice borrowed at the high price season, $(\text{Rupees } 60 / \text{Rupees } 20) = 3$ 'manunds' of rice had to be paid back just after the harvest, implying a 200% own rate of interest over a few months [6, p. 123].

It should be warned, however, that we cannot draw a general conclusion from the above sample statement with respect to the interest rate charged by the multiple-role moneylender, since we cannot establish empirically whether such fantastically high rates of interest is due to the monopoly or monopsony power of the moneylender, or due to the high costs of administration, storage, and transportation costs and risks involved in many transactions, e. g. transactions in land-lease, transactions in small, short and unsecured loans, and transactions in unpredictable markets for the seasonal commodity. 'High "own rates of interest" and low post-harvest crop prices may just be a reflection of the high costs of storage of the crop - costs which for some crops include very rapid depedation by insects, disease and fermentation' [25, p. 287]. Another evidence suggests that:

interest rates on agricultural loans in Thailand above 60 per cent per annum may still be consistent with competitive conditions if these rates prevail only on short loans of small size or on loans with a very high probability of default. Still even if all such rates are monopolistic the excess profit can be shown to be less than three per cent of total interest payments [30, p. 105].

In the case of the Vietnamese peasant economy, Sansom concludes that in 1966/67 the farmers were paying very low or negative real rates of interest for loans due to a high rate of inflation during the period [30, p. 105]. It is also well known, in a paternalistic peasant society where the symbiotic relationship between the influential triple-role moneylender and tenants is still strong, that the moneylender is supposed to take care of the financial problems of his customers. 'The older the established relationship — perhaps even going back several generations — the greater the likelihood of lower interest charges due to lower risk' [39, p. 35].

The apparent high 'own rate of interest' of the triple-role moneylender under the circumstance of heavy-weight agricultural indebtedness, has often led some writers to argue that the peasant farmers are exploited every possible way through his absolute economic power as monopolist and monopsonist, and they tend to conclude that 'agricultural development means putting an end to the depredations of landlords, moneylenders and monopolistic merchants' [1, p. 25] by means of the government control of the rural credit markets. It is, however, very difficult to support their arguments because 'they have offered no evidence that entry into the market as a creditor is not free' [30, p. 105] [23, p. 11]. The apparent monopoly elements of the moneylenders are 'build on their close contact with and intimate knowledge of local economic conditions : i. e. they can keep out potential competitors because of their ability to obtain the relevant local knowledge at a lower cost' [23, p. 11].

We seem to have now enough evidence to suggest that the government interventions in the rural credit markets by means of establishing the government-sponsored financial institutions and usurious laws to regulate

the alleged exorbitant interest rates have failed to achieve their designed abjective. 'The usuary laws, by reducing the supply of credit, can adversely affect the very people they are designed to help' [21, p. 287]. After having carefully studied the high interest rates in the unorganized sector of the many underdeveloped countries, U Tan Wai has concluded:

In many cases government legislation has caused the supply of rural credit to fall off and the effective interest rate to rise; the greater risks taken by money-lenders in evading the law have added to the cost of lending and sometimes have led to a higher effective rate of interest [36, p. 116].¹⁰

¹⁰For similar conclusions, see Myint [22, p. 11], Bottomley [8, pp. 436-437], and Fisk [12, pp. 141-152].

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