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Getting a microloan

The Microfinance Crisis in Andhra Pradesh, India: A Window on Rural Distress?

By Marcus Taylor¹

Microcredit has often been presented as an archetypal tool for addressing rural poverty. By placing small loans directly into the hands of women, proponents have argued that microcredit is able to achieve two feats simultaneously. First, it tackles poverty by unleashing the entrepreneurial abilities of the rural poor. Second, it breaks down patriarchal barriers by empowering women. Portrayed as a simple, progressive and effective development intervention, there seemed little to dislike about microcredit. Under the patronage of major international institutions, it was rapidly catapulted into the development mainstream in the 1990s and 2005 was pronounced the 'Year of Microcredit' by the United Nations. Leaving behind its origins in small-scale, locally based operations it has grown to become a multi-billion dollar industry that is increasingly operated on commercial lines in pursuit of scale and sustainability through profitability. Alongside the proliferation of microcredit (i.e. small loans), markets for other products such as microinsurance and microsavings have grown rapidly. Together, these kinds of financial products make up what is termed microfinance.

In recent years, however, the pristine facade of microfinance has become tarnished. On the one hand, a number of well-publicized studies have suggested that there is little hard evidence to show that microcredit is an effective means of alleviating poverty. While the industry itself has regularly promoted individual success stories, randomized studies of microcredit programs indicate no clear link between microfinance provision and income growth. On the other, there have been an increasing number of crises within the microfinance sectors of various countries. In particular, the dramatic expansion of microfinance in Andhra Pradesh, a state in southern India, ended in a crisis that caused significant ripples across the industry. The common response to this crisis has been to call for better regulated microfinance operations. The latter is undoubtedly important yet, in what follows, I suggest

that the Andhra Pradesh crisis opens a window onto bigger issues of debt and distress within agrarian India. We can only fully understand the Andhra Pradesh crisis by examining how the expansion of commercial microfinance became intermeshed with uneven processes of social transformation in rural India under liberalization policies since the 1990s. Within this context, the livelihood opportunities of small and marginal landholders were becoming increasingly squeezed, leading to a proliferation of debt in the Indian countryside. Before examining what occurred in Andhra Pradesh, however, it is useful to first briefly review what microfinance was expected to achieve in the first place.

What is Microcredit Meant to Do? This is not a simple question because there is no single model of microcredit. Different initiatives vary greatly according to their founding practices, the scale of the program and the particular environment it operates in.² That said, since the 1990s the global expansion of microfinance has been largely driven by a proliferation of commercially operated microfinance institutions (MFIs) that seek to provide credit and other services to those excluded from the formal financial sector. The logic is as follows: with little collateral, poor households tend to be excluded by the formal banking sector. This means that poor households are either cut off from access to finance or are forced to borrow from informal sources that are unreliable, expensive and prone to relations of dependency. Microfinance is then seen as the remedy to this exclusion: it is argued to provide the poor with a reliable and affordable source of financing to capitalize on otherwise unrealizable market opportunities, therein allowing them to lift themselves out of poverty.

Despite its wide propagation, this idea that the poor are repressed entrepreneurs who simply need

some capital to bootstrap their way out of poverty has been sharply criticized. On the one hand, many of the poorest households tend not to use loans to produce, but rather to consume. On the other, to the extent that microcredit is invested productively, most of the clients of microcredit have no specialized skills, few assets and face extremely competitive markets with insufficient capital to augment low levels of productivity. As Banerjee and Duflo note in their recent book *Poor Economics* (pg. 234):

Microcredit and other ways to help tiny businesses still have an important role to play in the lives of the poor, because these tiny businesses will remain, perhaps for the foreseeable future, the only way many of the poor can manage to survive. But we are kidding ourselves if we think that they can pave the way for a mass exit from poverty.

In response, the narrative surrounding microcredit has recently changed. Now the value of microfinance is not to be found in alleviating poverty but in enabling people to manage its symptoms. Access to credit allows poor households to juggle various income flows and expenditures that

Recent Critiques of Microfinance

Three recent books, available in paperback, provide important critical perspectives on the workings of commercial microfinance

• Milford Bateman, *Why Doesn't Microfinance Work?* Zed Books, 2010.

• Lamia Karim, *Microfinance and Its Discontents: Women in Debt in Bangladesh*, University of Minnesota Press, 2011.

• Ananya Roy, *Poverty Capital: Microfinance and the Making of Development*, Routledge, 2010.

might be uneven throughout the year. This is known as ‘consumption smoothing’ and while it might not immediately alleviate poverty, its benefit is suggested to lie in allowing households to deal with sudden shocks and expenditures without needing to sell important assets or take children out of school to put them to work. For many households, there is clearly some value in this form of risk mitigation. The big question, however, is to what extent does taking on microloans at interest rates between 24 to 36 percent create the possibility of debt traps in which poor households build up debts beyond their reasonable ability to repay?³ While the microcredit literature tends to glorify the benefits of ‘consumption-smoothing’, might growing over-indebtedness simply be the other side of the coin? Such questions can only be addressed within a specific setting, so it is useful to now turn directly to the Andhra Pradesh crisis.

The Andhra Pradesh Crisis

The state of Andhra Pradesh experienced a dramatic expansion of microfinance operations from the 1990s into the 2000s, becoming known as the ‘Mecca of Microfinance’ in India. Alongside a state-sponsored program that linked self-help groups (SHGs) to the formal banking sector, a commercially-operated microfinance sector expanded at breakneck speed over the 2000s. For example, in the fiscal year between 2009 and 2010 the number of microfinance loans in Andhra Pradesh increased by 26 percent and the overall volume of loans by 46 percent.

This expansion came to a shuddering halt in 2010 when the boom turned to bust. In October of that year a media storm blew up over the suicides of close to 50 microcredit clients whom, it was claimed, had taken their lives under the duress of crippling debt burdens and coercive repayment tactics initiated by microfinance employees. These suicides were



India microlending group

contrasted to the considerable fortunes made by the executives of microfinance corporations. The *Financial Times*, for instance, reported that Vikram Akula, founder of one of India’s biggest MFIs, had made a cool \$13 million from his company’s public offering shortly before the crisis. Considerable anger was vented at microfinance institutions that were seen to be accumulating riches at the expense of the poor. One government official quipped that: ‘The money lender lives in the community, at least you can burn down his house. With these companies, it is loot and scoot.’ In response, the Andhra Pradesh government clamped down on MFIs. This gravely affected MFIs ability to both collect existing debt payments and access further bank funds leaving the commercial microfinance sector engulfed in an unprecedented crisis with some companies facing insolvency.

What caused this crisis? Observers have generally focused on the failings of the MFIs, who were seen to have succumbed to a form of ‘irrational exuberance’ that led to systematic overlending and then ruthless collection practices. Elisabeth Rhyne, managing director of the Center for Financial Inclusion at ACCION International, puts this in a direct manner:

Like sex, microfinance can be safe if practiced responsibly. Recently, however, we’ve seen that not all participants in the microfinance industry are practicing safe

microfinance ... one need look no farther than Andhra Pradesh.

Rhyne has a point. Without doubt, many of the microfinance institutions in Andhra acted in an entirely predatory manner, in part to meet the profit expectations of shareholders. MFIs engaged in systematic overlending where instead of finding new clients, they lent to households who already had loans from other agencies. They were aggressive in their pursuit of clients and often hid the full extent of charges. Moreover, in order to meet new disbursement goals and ensure continued repayments of existing debts, some MFIs went so far as to outsource their operations to local agents who happened to be the very moneylenders that microfinance was supposed to displace! Violent forms of collection began to arise and, despite protests of innocence at the time, subsequent investigations have indeed traced suicides directly back to the MFI collection practices.⁴

But was the Andhra crisis simply a question of bad regulation and irresponsible lending? What I have argued in my recent work is that poor regulation is only one part of the problem. To focus simply on regulation is to ignore the profound changes happening across rural India that have created widespread insecurity in lives of marginal and small-holder farmers. Since the 1990s, a series of policy changes were intended to promote a rationalization of Indian agriculture by reducing input subsidies and tariffs and other liberalization measures. It is not possible here to do justice to the complexities of agrarian transformation that have resulted.⁵ However, four primary overlapping processes can be identified that served to increase the vulnerability of small and marginal farmer households in the new agrarian environment. First, the smallholder sector has continued

to expand in numbers, with a significant increase in marginal holdings of under two-hectares that are insufficient to provide adequate income for household subsistence. This forces the majority of rural households to attempt to make ends meet by combining agriculture with other livelihood strategies: often through waged work, informal sector commerce and temporary migration of male household members to other regions or cities. Second, there has been a shift toward cultivating high-risk crops that requires extensive outlays of capital on inputs (seeds, fertilizer, irrigation) and has fostered dependence on volatile market prices. Third, owing to the undermining of common property resources and the retrenchment of a number of welfare services since the 1990s, there has been an individualization of risk across agrarian India. And fourth, rampant soil degradation and groundwater depletion indicate the increasing exhaustion of the ecological basis for an increasingly commercialized agriculture.

The outcome of these trends includes heightened social differentiation across rural India on the basis of class and caste. While some have prospered within commercial agriculture, the policy paradigm has simultaneously created new forms of precarious existence as households are squeezed between the insecurities of smallholder farming and the expansion of informalized day laboring, petty production and commercial activities that offer only marginal returns. The impact of rising living costs and precarious incomes is exemplified in the difficulty landless and marginal farmers had in meeting basic consumption needs particularly in times of drought which occurred more frequently during the 2000s, potentially related to broader climatic shifts under global warming.

Under conditions of acute agrarian strain, households saw loans—both from microfinance companies and informal sources—as a temporary salve to their problems. In short, the growing demand for microfinance in rural Andhra Pradesh was symptomatic of a smallholder and landless population facing severe strains. Multiple borrowing became a common strategy of households who used newly available credit from varied sources, including microcredit agencies and moneylenders, to sustain consumption while paying off old debts. A 2011 study in Andhra showed that 71 percent of surveyed MFI clients had taken three or more simultaneous loans from different MFIs of 10,000 rupees or above. This so called ‘consumption smoothing’ created a cycle of escalating indebtedness that left many households facing the possibility of financial implosion in the face of external shocks such as illness, crop failure or economic downturn.

Under these conditions, microfinance in Andhra Pradesh itself became a vector of insecurity that cut into households that sought credit to alleviate the immediate pressures of an agrarian transition which left them increasingly marginal within the constraints of neoliberal India. Caught between the twin pressures of insecure livelihoods and a rapacious microfinance sector, many families increased their dependence on short-term and expensive credit as a survival strategy. While such borrowing practices might work for a time, so long as new credit is available to pay off old debts, for some the net result was one of escalating indebtedness with tragic results.

What does this all mean?

Undoubtedly, under conditions of considerable agrarian distress across South Asia, there is a need to inject

resources into rural areas to bolster the livelihoods of the poor. It is possible that appropriately designed microfinance that places subsidized credit provision within a wider spectrum of measures to promote collective empowerment may have a place in such a scenario. But it must be kept in its place. The Andhra Pradesh case demonstrates two points. First, there is certainly a need to better regulate and potentially restrict the activities of commercial microfinance institutions. In Andhra Pradesh, intense competition for borrowers between these companies led to systematic practices of over-lending and coercive debt collection. While these trends may have been particularly acute in Andhra, other studies suggest that they are commonplace across South Asia.⁶

Second, and most importantly, microcredit is no substitute for a meaningful strategy of revalidating smallholder livelihoods. The latter, while encompassing the bulk of the population in South Asia, have suffered under liberalization reforms and the pressures of an increasingly corporatized global agricultural environment. While microfinance was often presented as something of a ‘magic bullet’ solution that could allow rural households transition away from agriculture and invent new livelihoods for themselves, it is thoroughly insufficient for such a task. On the contrary, as the Andhra case showed, it can actually exacerbate the creation of debt traps among poor households, at the same time as transferring profits to the financial sector.

Of course, revalidating smallholder agriculture in South Asia is a huge and complex challenge that would require a macro-scale reworking of the political-economy of agriculture. Fundamental to any such project

would be a close engagement with precisely the kinds of issues that rural social movements have repeatedly articulated over the past two decades: substantive land reform, protection of agriculture from subsidized foreign imports, public investment in infrastructure, a restructuring of rights over irrigation, effective guaranteed minimum prices for crops, an end to commercial encroachment on common property resources, protection of laborers from the power of landlords and labor contractors, and subsidized forms of credit made available to smallholders and tenant farmers.⁷ These are the kinds of foundations that a reconstruction of a more socially just rural society must proceed from.

Endnotes

1. Marcus Taylor is an Associate Professor at the Department of Global Development Studies, Queen's University, Canada. He can be reached at marcus.taylor@queensu.ca. This short piece summarizes two longer academic articles both published in the *Journal of Agrarian Change*. (1) “Freedom From Poverty is Not For Free”: Rural Development and the Microfinance Crisis in Andhra Pradesh, India,” 11(4), 2011. And (2) “The Antinomies of Financial Inclusion: Debt, Distress and the Workings of Indian Microfinance,” 12(4), 2012.
2. For example, microfinance can be run by for-profit firms, state organizations, or non-governmental organizations. Each may place greatly different conditions on borrowing, including the level of interest rates and the degree of training and support services provided. The critique levied here is primarily aimed at the commercialized version of microfinance that places heavy emphasis on fiscal sustainability through profitability.
3. The 24-36 percent interest rates are typical within the Indian context, although fees can push the overall costs higher for borrowers. Elsewhere microcredit can be significantly more costly: the Mexican lender *Compartamos* operates at rates above 100 percent.
4. Kinetz, Erika., 2012. ‘Small loans add up to lethal debts,’ *The Hindu*, Mumbai, February 25. <http://www.thehindu.com/news/national/article2932670.ece?homepage=true> [accessed February 26, 2012].
5. Aside from articles on the Food First website, those wishing for a strong overview might well track down Reddy, D.N. and S. Mishra (eds), *Agrarian Crisis in India*. Oxford University Press, 2009.
6. See Lamia Karim's recent book mentioned in the box above.
7. See, for example, the final report of the *Commission on Farmer's Welfare* published in Andhra Pradesh, available at http://www.networkideas.org/alt/apr2005/alt07_Farmers_Welfare.htm [accessed February 5, 2012].

