SOCIO-POLITICAL DIMENSIONS OF INSTITUTIONAL CREDIT ALLOCATION IN INDIA

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A developing country like India faces the tough challenge of ensuring growth with distributive justice so as to ultimately establish a welfare state. Towards this end, the credit policy of the Reserve Bank of India can go a long way in providing institutional loans to the economically weaker and downtrodden sections of the society. Going by the purely economic logic, however, the credit allocation would tend to get biased in favour of the rich and large borrowers who are always in a position to conveniently furnish security be it primary or collateral in nature and in whose case the average costs of servicing the loan are also relatively lower due to the standard economies of scale argument. Thus on ethical and moral grounds, the monetary authority accords precedence to welfare considerations over economic ones while devising its credit policy. Yet in actual practice, the commercial banks and other financial institutions within the organized sector have essentially been observed to favour their richer clients at the cost of the poor and small borrowers largely on account of certain socio-political factors that work to the detriment of the underprivileged and deprived sections of the society. The purpose of the present paper is to delve deeper into the underlying dynamics of such social and political factors and carefully analyse the social repercussions of the resulting violation of ethics in the allocation of institutional credit in India. It is based on the paper 'Ethical Issues in the allocation of Institutional Credit' presented by the author at a national seminar on ethical issues in business and finance jointly organised by S.R.C.C. and ICAI on November 22, 1998 at Vigyan Bhawan, New Delhi.

Owing to the developing nature of the Indian economy, the financial institutions within the organised sector are entrusted with a far greater responsibility of uplifting the poor and downtrodden sections of the community in the Indian context. For 'growth with distributive justice' with a view to ultimately establishing a *welfare state* has by far remained the most important policy goal of the monetary authority in India. As is widely acknowledged, the Indian economy is characterised by large inequalities in the

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distribution of income and wealth. Thus in order to bridge the gap between the rich and poor sections of the society, the central bank viz. the Reserve Bank of India has set up certain guiding principles for the allocation of credit by the financial institutions coming under its direct control such as the commercial banks, co-operative banks and development banks.

These guidelines or rules of the game governing the allocation of institutional credit in India not only take into account the economic logic but also run on the lines of moral and ethical considerations. This is primarily because economic considerations *per se* would work to the detriment of the economically weaker and underprivileged sections of the society. For instance, in order to ensure against the *risk of default*, if the banks and financial institutions start insisting on primary and collateral securities then a large majority of the poor sections of the society will be deprived of institutional credit availability despite deserving it the most since due to their lower economic status, the poor people are generally not in a position to furnish any kind of security or guarantee. Moreover, the average cost of servicing loans also turns out to be lower in the case of rich and large borrowers vis-a-vis the small borrowers since the processing costs are spread out over a larger amount in case the bank lends to a large rich borrower thereby exploiting the *economies of scale* generating therefrom. This proves to be an added economic factor working against the small and poor borrowers. Thus strictly adhering to the economic logic, loans will be provided to only those who are already rich and as a foregone conclusion, more and more credit will be given to those who already have enough of it at their disposal. Evidently, such a discriminatory distribution of institutional credit is not justifiable on ethical and moral grounds since the rich are often observed to indulge in conspicuous consumption on luxurious commodities and socially undesirable activities while at the same time a large proportion of the poor and underprivileged sections of the society are deprived of even the basic minimum necessities of life!

It is against this backdrop that while framing its monetary and credit policy, the Reserve Bank of India has explictly recognised the fact that institutional credit should be sanctioned on the basis of the credit-worthiness of the purpose for which it is sought rather than on the basis of the credit-worthiness or financial status of the borrower. Yet we typically find that in actual practice, the financial institutions tend to favour their richer clients at the cost of poorer ones in the disbursement of loans and credit. This biased attitude on the part of financial institutions manifests itself in numerous forms. While liberal and prompt financial assistance is given to favoured parties even for dubious projects, the economically weaker and poorer sections of the society are usually subjected to administrative delays, red tapism and all sorts of harassing rules and conditionalities. In this way, the poor borrowers are practically given a *step-motherly treatment* so to say thereby violating all the ethical rules and moral code of conduct as stipulated by the Reserve Bank of India in its credit policy. This evidently raises the pertinent question as to why does this happen that there is a significant divergence between what the central bank officially prescribes and what the commercial banks and financial institutions under its direct supervision in effect practise. In order to answer this question, we have to necessarily address ourselves to the mixed democratic capitalist framework adopted in India and the socio-political institutional realities arising out of its degeneration over time which has in turn led to the complex problems of *corruption, nepotism, nexus between the rich and influential sections of the society on the one hand and political and bureaucratic wings of governance on the other.* That is to say, the violation of ethics in the allocation of institutional credit in the Indian context is essentially attributable to the multiplicity of socio-political factors impinging on each other in a complex manner.

It is a well known fact that the managers of these financial institutions share a common social background and thus identify themselves with the economically well-off and influential sections of the community. More specifically, the bank managers and the administrative officers of different financial institutions uphold more or less similar outlook and the same social values and aspirations as those of the richer strata of the society. These social ties and the resulting nexus between the managerial staff of financial institutions and their richer clients are further strengthened by the adoption of certain *illegitimate* and *unscrupulous* means by the latter as for instance bribing the management of commercial and development banks either in cash or in kind via holding dinners and cocktail parties in five-star hotels, presenting expensive gifts and offering lucrative jobs to the top executives of financial institutions after their retirement etc. All these corrupt practices in effect develop *an unethical symbiotic relationship* between the two parties which obviously goes against the interests of the small borrowers who are invariably not in a position to afford any direct or indirect gratification for the bank managers. Consequently, the borrowers belonging to the economically worse-off sections of the society who are generally ill-informed and less organised also, are treated as more of a headache rather than a welcome customer by the financial managers. *It is quite evident that such a pathetic state of affairs and the apathetic attitude of bank management towards their poor clients entirely contradicts with the basic spirit of the credit policy in India which is primarily designed to cater to the needs of the economically poor and deprived sections of the society.*

The problem is further compounded by the operation of certain political factors that again work to the detriment of the downtrodden sections of the society. For it is well documented that the incidence of default in the repayment of principal amount as well as the interest rate on official loans is higher in the case of large borrowers vis-a-vis the small borrowers. This paradoxical observation can easily be explained in terms of the underlying political dynamics wherein the big borrowers belonging to the richer sections of the society are pampered to such an extent by their political patrons that despite possessing the financial capacity to repay, they deliberately choose to remain dishonest and exercise their political influence to get the concerned loans waived-off altogether under some pretext or the other. It is therefore not surprising that under such a scenario, the financial institutions are confronted with the serious problem of *overdues* whereby a large proportion of public funds gets blocked for all practical purposes, which cannot be rechannelised towards the poorer and deserving sections of the society. As a result, *the economically weaker and small borrowers suffer for want of funds, which clearly is contrary to the basic spirit and ethics of credit allocation in the Indian context.*

In the light of the foregoing discussion, it can be reasonably concluded that apart from formulating its credit policy on ethical and moral grounds, the monetary authority in India will have to pay more attention to its proper implementation so that the functioning of various financial institutions within its purview could broadly conform to these ethics of credit allocation. If and only if the Reserve Bank of India is somehow able to condition the working of commercial and development banks in the socially desirable direction will the credit policy be able to attain the twin objectives of ensuring growth with distributive justice in the Indian economy.