Microfinance: does it affect rural poverty reduction? The case of two villages in southern India

By

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Abstract

Given that microfinance requires regular financial contributions either as savings or repayments, examining *who* has access to microfinance is a critical first step in understanding how microfinance influences rural poverty reduction. This paper argues that while microfinance may facilitate livelihood diversification, *what* microfinance is used for and to what effect would depend on a household's existing endowments, assets and capabilities as well as the political economy of the community. If used to build assets, microfinance may, over time, lead to increased endowments and reduce poverty. However, this study shows that microfinance does not exist in isolation: taking into account structural, institutional and other influencing factors that affect people's livelihoods is important to understand the dynamics of microfinance in a rural setting. Based on the case of two villages in southern India, this study shows that microfinance does not challenge the social relations of production.

19 May 2009

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Abbreviations

FI	Financial Inclusion
GDP	Gross Domestic Product
IG	Inclusive Growth
NABARD	National Bank for Agriculture and Rural Development
NGO	Non-Governmental Organization
NSS	National Sample Survey
RBI	Reserve Bank of India
SHG	Self Help Group
SLA	Sustainable Livelihoods Approach
SRLA	Sustainable Rural Livelihoods Approach

CHAPTER ONE

Introduction

Rural India today has half of its farmers in debt and under a third living in poverty (see Appendix 1). There has been a large-scale shift towards commercial farming, while at the same time national food stocks are declining, yields are decreasing, and there is a decline in agrarian productivity. In addition, the liberalization, deregulation and privatization reforms of the early 1990s have resulted in the closure of state run rural banks and a rural credit gap (Radhakrishna, 2008). In light of this situation, how does microfinance affect rural poverty?

The last five years have seen a transformation in India: rapid economic growth, changes in the composition of that growth and a changed political leadership with a new vision of development: 'Inclusive Growth'. Inclusive Growth aims to integrate the county's poor in its growth trajectory, integrating the informal sector into the formal financial markets[1]. The Self-Help Group-Bank linkage program, India's large scale microfinance initiative, is an important tool in this strategy of Inclusive Growth[2]. This model of microfinance in India has the dual challenge of 'financial inclusion' and poverty alleviation:

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[1] Formal finance refers to financial services delivered through a financial institution licensed by a State. Microfinance is defined as the delivery or use of small amounts of financial services, including credit and savings.

[2] While Inclusive Growth is a policy initiated the current government, the SHG Bank linkage program was initiated by the National Bank for Agricultural and Rural Development (NABARD) in the early 1990's (NABARD website). See Table 10 in the Appendix. However, microfinance and the SHG Bank Linkage Program have been highlighted as key tools in achieving inclusive growth.

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth.

NABARD Report of the Committee on Financial Inclusion, 2007

While India's economy has been growing at an average rate of over 7% per annum over the last five years, this growth has been far from equitable[3]. India is also experiencing unequal levels of growth in different sectors of its economy. The low rates of agricultural growth coupled with declining national food production have resulted in what is being called an 'agrarian crisis'[4] (Radhakrishna, 2008). With 71.5 % of the country living in rural areas and 60% engaged in agriculture, it is imperative to examine what effect macro level changes in both policy and statistics have on people living in rural India. More specifically, it is important to examine whether the initiatives of inclusive growth are indeed having the poverty reducing effects on the poor as intended. With over a quarter of India's rural population living below the poverty line, this study examines how a poverty alleviating tool like microfinance is being used, what affect it has on rural livelihoods, and the implications for the country's development.

The Self-Help Group (SHG) Bank Linkage program, a national microfinance program, has been billed as "the most potent initiative since Independence for delivering financial services to the poor in a sustainable manner" (Report of the Committee on Financial Inclusion, 2008, 3). The SHG Bank Linkage program has been hailed as a

[3] India has a Gini index of 36.8 for the distribution of income and ranks 128 of 177 countries in the Human Development Index (UNDP Human Development Report 2008).

[4] While agricultural growth is around 2% and makes up 20% of GDP, service sector growth is 11% and contributes to around 55% of GDP. However, as 60% of India's workforce is engaged in agriculture, this translates into low agricultural productivity and low agrarian per capita income (Radhakrishna, 2008).

success for having 40.5 million microfinance borrowers in 2007 and facilitating financial inclusion (Thorat, 2008). With the bulk of India's poor living in rural areas, this study focuses on rural livelihoods and assesses change with regards to peoples' lives. Finance, including microfinance, is thus examined as a tool to reduce poverty. Whether, how and to what extent microfinance contributes to poverty reduction in rural settings are central questions of this study. However, poverty has multiple layers and rural livelihoods are almost never homogeneous: understanding the context, hierarchies and environment in which microfinance is implemented is an important part of understanding how change does or does not happen.

Research Question

Using the example of the Self-Help Group Bank Linkage program in two villages in southern India, this thesis examines how microfinance services are being used by people living in rural areas, and what difference it makes to their lives. In particular, the thesis addresses the central question of: *whether, how and to what extent does microfinance contribute to poverty reduction in rural settings?*

Specific operational questions are:

(a) In light of the political economy of rural livelihoods, who has access to microfinance: do the rural poor have access to it?

(b) What do microfinance recipients do with the borrowed money in relation to their livelihoods?

(c) In what ways does microfinance influence the livelihoods of the borrowers, particularly how it contributes (if it does) to poverty reduction?

CHAPTER TWO

Literature Review

Introduction

While agriculture is of diminishing value to India's GDP (around 20% of GDP in 2004-05), it is by far its most important employer, engaging 60% of the population (Radhakrishna, 2008)[5]. What happens to Indian agriculture, therefore, is not only relevant to national food stocks and agricultural exports, but also to the livelihoods of most Indians. In addition to those engaged in agriculture, there is a growing non-farm economy in India, with a total of around three quarters of India's population living in rural areas. Given the significance of agriculture and rural residence in India, it is extremely important to understand the changes that are taking place in rural landscapes and the implication of large scale trends on rural livelihoods. This chapter draws out the macro and micro level debates and changes in rural development to identify the linkages between the two and to situate this study. Understanding the dynamics of the socio-political economy of rural livelihoods is a prerequisite of analyzing the effects of microfinance on the lives of people living in rural areas.

Rural society in India is far from homogeneous and far too often the term 'rural' has been equated with poverty. Keeping in mind the heterogeneity of the rural socio-economic fabric, this study deconstructs rural society in a changing rural landscape, examining the poorer sections of rural society in both an agrarian and non-agrarian rural context in order to understand the multiple layers of issues that affect different sections of

[5] See Table 3 for further data on the declining contribution of agriculture to India's GDP.

rural society and the implications of rural development initiatives. Small-holder farmers are the focus of this chapter as small-holder farming is the largest source of employment for the rural poor (Motiram and Vakulabharanam, 2007). Microfinance, defined as small amounts of financial services, including savings and credit, is examined first in relation to issues of rural development, rural livelihoods and rural poverty; and then as a particular model of microfinance applied in the Indian case study.

Rural development

Rural landscapes are almost never homogeneous, and understanding what socio-economic differences exist, and why they exist, are important pre-requisites in understanding how an initiative like microfinance may or may not influence rural livelihoods. Moreover, any analysis of rural poverty reduction needs to examine who is being affected, how, and with what implications. What factors influence *how* different people are affected differently requires some understanding of *why* they are situated differently in the first place. Bernstein (2007) identifies four questions to consider in agrarian political economic inquiry: who owns what; who does what; who gets what; and what they do with it and how? This chapter argues that in a rural setting, who gets what and who does what are significantly influenced by the following three factors:

1. people's endowments / assets;
2. structural barriers and
3. production relations

Any intervention to influence people's livelihoods must take into account these factors while examining the effect of the intervention on people's lives. With small-scale farming the most prevalent occupation in rural India, understanding how these factors relate to small scale farming is important before examining how microfinance may be able to influence change in this setting. This chapter analyses the political-economy of rural livelihoods: examining the structural constraints faced both by those engaged in agriculture, and those engaged in non-farm employment, with an emphasis on the rural poor.

In his analysis of the political economy of the peasantry[6], Ellis highlights the "inseparability of short run household decisions from the wider social relations of production," (Ellis, 1988, 237). "For economic analysis these social relations are manifested by departures of varying degrees from the pure market relations on which the main body of microeconomic theory is predicated" (Ellis, 1988, 241). He defines peasants as family farmers partially integrated into incomplete or imperfect markets. Being exposed to market forces such as market valuations of agricultural inputs and outputs could both provide the opportunity for a higher standard of living, but could also include the possibility of devastating effects due to adverse price trends. These points are particularly important as they highlight three key features of agrarian production:

1. While neo-classical economic theory assumes that markets are competitive and self-regulating, in practice markets are not perfectly 'free' of barriers or inequalities in the ability to participate in a market on an equal footing. Inequalities in agrarian production or primary commodity markets include disparities in endowments or access to productive resources as well as domestic and international price fluctuations and commodity trade relations. The declining

[6] The terms 'small scale farmers' and 'peasants' are used interchangeably in this paper. 'Peasants' is a term used in a political economic analysis, while 'small scale farmers' is used in sustainable livelihoods discourse. Small-holders, meanwhile, is term that is often utilized in neo-classical economic analysis and refers to small-scale farmers who are presumed to be self-interested and whose actions are abstracted from their political and social contexts.

terms of trade for agricultural produce as well as agricultural subsidies in some countries are some of the contributing factors towards the disparities in agricultural markets, leaving small-holder farmers particularly vulnerable.

2. Depending on how people are situated in the socio-political economy, particularly in relation to the means of production, market fluctuations affect different people differently.

3. *Access* to productive resources is a key factor in production relations. Structural barriers to resources for agricultural production would include barriers to access:

   - Inputs or physical resources: such as seeds and fertilizers; mechanical inputs; land; water
   - Financial resources: credit to purchase inputs, engage in production and market produce
   - Human resources: labour, skills and knowledge
   - Market and Institutions: access to markets and institutions

Under neo-liberal policies implemented since the 1980s, states encouraged the liberalization, deregulation and privatization of their national economic institutions, including national banks. Private banks were unable to sustain the high transaction costs of operating in rural areas and the rationale for closing rural bank branches was that state-run finance was seen to be 'supply' rather than 'demand' driven (Satish, 2007). As national banks were often the sole providers of agricultural credit, the privatization of banks and the closure of a large number of rural branches left people in rural areas without access to credit or formal financial services. This in turn has increased the vulnerability of farmers, often compelling them to sell their goods to intermediaries, to whom they become indebted (Motiram and Vakulabharanam, 2007). Microfinance is now seen as a possible solution to the problem of a rural credit deficit in post-reform societies like India. Motiram and Vakulabharanam (2007) argue that cooperatives are the primary solution to the 'agrarian crisis' in developing countries. Another solution proposed to this problem has been contract farming, which can be either commercially based agribusinesses, or state-agribusiness partnerships. Under this arrangement, the agribusiness provides the farmers agricultural inputs on credit to grow crops on a pre-specified amount of land and for repayment, the farmers are bound to sell their produce to the agribusiness at a pre-determined, fixed price. As Motiram and Vakulabharanam point out, while this arrangement provides the farmers a guaranteed access to credit and markets, thus lowering their 'risk' while bypassing intermediaries, the farmers lose control over the production process, their choice of agricultural inputs as well as the use of their land. Moreover, the farmers are still at a risk, as, despite following the procedures, agribusinesses are able to turn away produce based on 'quality' standards, if they have over-contracted the crop and are facing a surplus.

Enhanced by liberalization policies, the commercialization and the increased role of the private sector, particularly large, multinational agro-corporations, have had a huge impact on the lives of small and marginal farmers. Berdegue and Ravnborg (2007) see the current debate as polarized between strategies aimed at increasing rural farm employment and reducing food prices through large scale commercial farming versus strategies aimed at improving the farming practices of poor, marginalized farmers. The focus on 'niche' markets of higher value crops for export has left behind the domestic market, which is of more importance to small-holder farmers who are unable to afford the high input costs and risks associated with converting to higher-value crops. The livelihood options faced by small scale farmers are thus contingent on the larger macroeconomic forces of national agrarian policies and international trade. Due to the changing demographics in developing countries, urbanization and the increasing prominence of supermarkets, food consumption patterns in the domestic markets of developing countries are changing rapidly. This poses a challenge for small-holder farmers, who are left between the rock of diversifying their crop production or the hard place of being displaced by richer farmers and imports. Structural inequalities such as access to land, water, capital and information, according to Berdegue and Ravnborg (2007), make adapting to the change even harder.

The Green Revolution in India was an attempt at increasing food production to achieve national food self-sufficiency. However, it also led to increased inequality and marginalization in rural society (Dutta, 1992). As Bernstein (2001) and others articulate, while the technology of the Green Revolution was scale neutral, it was not *resource* neutral, and depended on a minimum level of resources and capacity to take risks, which poor peasants lacked. State-run agricultural credit was also given to larger farmers able to engage in commercial production. This both reflected and reinforced class differentiation. Apart from the immediate fallouts, such as the creation of large scale unemployment in the agricultural sector due to the mechanization of agriculture, the profits from the increased yields went only to the rich farmers with larger landholdings, leaving behind the bulk of the sector comprised of small-scale agriculture and marginal farmers (Dutta, 1992). In addition, the high costs of pesticides and fertilizers drove many farmers into debt.

Therefore, while access to finance is a crucial component of peasant production, it is but one of the many structural barriers faced by small scale farmers in a neo-liberal setting. The example of the Green Revolution highlights the fact that the *availability* of finance doesn't necessarily translate to the *access* to finance by all members of peasant society. How people are situated in relation to the means of production is therefore a vital component of how they are able to interact with and benefit from the market. When examining changes to small scale farming, access to financial capital, therefore, needs to be considered in relation with the other influencing forces and constraints faced in small scale agrarian production.

Therefore, any intervention aimed at small scale farmers, including microfinance would need to take into account the structural inequalities and barriers faced by small scale farmers. While microfinance initiatives may aim to overcome structural barriers to the access to finance, as highlighted in the discussion above, it is not the only element of agrarian production. Indeed, small scale farmers may face multiple and overlapping structural constraints as discussed below.

Risks and vulnerability

Traditional risks associated with agriculture include environmental and weather related risks such as diseases and drought. However, in a market setting, the demand for agricultural produce is another significant risk factor that farmers face: the larger the market, the greater the risk.

> Vulnerability takes different forms because it arises from different causes. Like poverty, it can be structural or transitory, reflecting risk from routine or predictable phenomena or unanticipated risks.
>
> Kabeer, 2002, 593

Morduch (1994) introduces the concept of risks and vulnerability to the poverty discourse, identifying weather and price variability as major causes of income fluctuations and, consequently, of poverty, with respect to agriculture. According to the 2008 World Development Report, negative shocks can deplete assets through distress sales of land and livestock, leaving people with a choice between reducing consumption and depleting assets. Indeed, Morduch argues that the lack of access to consumption-smoothening mechanisms should be a measure of poverty. Kabeer takes this point further, arguing that "fluctuations in the incidence of poverty thus provide us with an aggregate indicator of vulnerability, since they track the movement of households into, and out of, poverty" (Kabeer, 2002, p. 593). She points to the existence of the "vulnerable non-poor" or "tomorrows poor": people who are marginally above the poverty line but whom any crisis may push into poverty. These factors contribute to social differentiation and are critical in understanding the composition of rural society. When analysing whether and how microfinance contributes to rural poverty reduction, it is important to keep in mind these different risks and vulnerabilities, both in order to examine the cause of poverty, as well as to examine the effects that microfinance can have on poverty reduction, in light of the risks and vulnerabilities faced by the poor. Specifically, what the poor may or may not be able to use microfinance for could depend on combination of risks and vulnerabilities they face.

"Pro-poor" agriculture

With a large number of rural poor engaged in agriculture, understanding the constraints faced by small-scale farmers is a key pre-requisite in designing rural poverty reduction policies. One of the main policy prescriptions aimed at reducing rural poverty is "pro-poor" agriculture, with microfinance seen as a facilitating tool in this policy. The International Fund for Agricultural Development (IFAD 2001) identifies the following factors as key to reducing rural poverty: access to assets, both physical and financial; technology and natural resources; and markets and institutions in a "pro-poor setting". According to IFAD, "Widening market access and liberalization increasingly allow rural people to escape poverty through non-staples production and exchange. In this process non-farm assets and skills are critical, as are infrastructure and institutions to help small units to maintain market access during globalization" (IFAD, 2001, 3). While not completely discounting small scale agriculture, this view falls in line with the World Bank's vision of 'agriculture for development.'

The World Bank in its 2008 World Development Report, Agriculture for Development, puts forward four ways in which it claims agriculture can reduce poverty:

- by improving the asset position of the rural poor
- making small holder farming more competitive and sustainable
- diversifying income sources towards the labour markets and the rural non-farm economy
- facilitating the successful migration out of agriculture

The second point of the World Bank is based on the 'poor but efficient' theory of smallholder farmers (originally proposed by Shultz), which derives from the neo-classical approach to rural development. According to this theory, smallholders behave in an economically rational way, with the primary objective of maximizing profits. This includes engaging in production with regards to their comparative advantage, and being responsive to the prices of agricultural inputs and outputs. However, focusing only on production based on a farmer's comparative advantage without taking into account the political economy of the agrarian context results in issues similar to those raised in the 'niche markets' discussion earlier.

The idea of orienting small scale agriculture towards market production not only discounts the existence of structural barriers that prevent small scale farmers from participating effectively in the market, but also ignores the polarizing effects of social differentiation. Reorganizing small scale production towards externally determined 'comparative advantage' sets the stage for further social differentiation, marginalizing those unable to compete in the market. As seen in the example of the Green Revolution, effective market oriented production not only requires access to credit, technology, skills etc, it also requires the capacity to undertake expensive and risky ventures. Benefits, therefore, go towards the better endowed, marginalizing the rest. This is important to highlight in order to understand rural social differentiation- not only what contributes to it, but also the different factors an intervention such as microfinance would have to take into account. Examining *who* is able to access microfinance or who is able to benefit from it is thus a crucial aspect into the inquiry of the impact of a phenomenon in a rural setting.

While microfinance provides access to finance, what the finance is used *for* is also important to examine. One of the structural barriers in agrarian production is the lack of affordable financial services. While microfinance is aimed at providing access to finance, it is important to keep these issues in mind before advocating the use of microfinance for commercial agrarian production. However, by design, microfinance may be difficult to use for commercial agriculture. As Motiram and Vakulabharanam's point out, microfinance is based on a repayment rate of small amounts at regular intervals, making it difficult to use microfinance for agricultural production or long term agricultural projects, as agricultural production does not yield small, regular returns, but rather a usually single, large return during the harvest season. Moreover, microfinance is not involved with the marketing of the produce. Examining the trade off between using microfinance to build endowments or productive assets such as land versus spending it on inputs is also significant – making microfinance for commercial agrarian production conducive to those who may already have a significant asset base and require only small supplements in capital to engage in production.

Diversification

As discussed, rural livelihoods include both agrarian and non-agrarian livelihoods. There is a growing amount of literature that points to the fact that rural livelihoods are not necessarily related to agriculture (see, for example, Tacoli 1998 and Rigg 2006). Livelihood diversification in rural areas could be both non-farm activities, such as rural industry, or on-farm and allied activities, such as rearing livestock. Razavi (2002) outlines Ellis' work on rural livelihood diversification, where she argues that diversification could be either a deliberate household strategy or an involuntary response to crisis; a method for accumulation for the rural rich or a safety valve for the rural poor; a method that could either diminish or accentuate rural inequality.

According to Bryceson (1999), rural income diversification is a result of the growing shift from agriculture to non-agricultural earnings. She defines rural income diversification as "an expansion of rural dwellers' income sources away from own farm labour" (Bryceson, 1999, 3). She argues that rural income diversification does not translate into increased rural productivity in the African context as it is not accompanied by the necessary skills training[7]. While in her analysis, Bryceson equates income diversification to non-agricultural activities, this may not always be the case. Shifting from agrarian to non-agrarian activities and diversifying income sources are two distinct, although often overlapping issues. While one is the transition from one livelihood activity to another, the other is the expansion of livelihood activities while continuing the original.

Bryceson critiques the economic rationale for diversifying to non-agricultural activities to avoid the sole reliance on one activity, stating that this analysis overlooks the fact that economic liberalization has in fact *increased* the uncertainties in rural production and marketing. She further argues that while income diversification is "considered to be an expression of economically rational risk management…reducing the household's vulnerability to agricultural fluctuations and rural market imperfections" only wealthier households are able to benefit from this due to their higher skills and asset endowments (Bryceson, 1999, 5). Bernstein (2001) takes this point further, stating that the type of diversification is structured by class relations, with poorer peasants most likely to shift to wage labour, middle peasants to engage in wage labour and other income diversification activities, while richer peasants would diversify to wealth accumulating activities.

This has significant implications for the use of microfinance as a livelihood diversifying tool. According to Rajasekhar (2004), "[m]icro-finance aims at providing the rural and urban poor, especially women, with savings, credit and insurance facilities to set up or expand income generating activities, and to improve household income security" (Rajasekhar, 2004,1). Examining what people are able to do with their loans will shed

[7] The lack of training and knowledge is a key feature of the micro-entrepreneurship debate, where 'micro' loans are given to women to start small businesses, often without adequate training with unsustainable results (Microcredit Summit 2006, Halifax). Moreover, credit is also debt, with Mayoux (2003) flagging the potential of microcredit loans leading to a downward spiral into poverty.

light on whether people are diversifying their livelihoods, under what conditions and to what effect. If microfinance is used to diversify livelihoods, it would be important to consider whether it is done in a way that reinforces or overcomes class barriers[8].

Rural non-farm employment

Transitions from agrarian to non-agrarian livelihoods

Understanding the political economy of non-agrarian livelihoods is equally important in order to examine the constraints and choices available to the rural poor not engaged in agriculture. There are two opposing views on the growth of rural non-farm employment: one based on *choice* and the other on *necessity* (Jayaraj, 2004 and Ellis, 2000). While one view suggests that rural non-farm employment increases with agrarian prosperity and agricultural growth linkages, the other suggests that non-farm employment is a result of agrarian distress and poverty. However, according to Jayaraj, both arguments are incomplete as neither takes into account seasonality and social factors as factors that influence the demand for non-farm goods and as factors that constrain skill accumulation.

Rural non-farm employment has also been regarded as a solution to agrarian underemployment and a strategy to prevent mass migration to urban areas (Saith, 1999). Analysing the structural transformation of the rural workforce, Jayaraj argues that the casualization of the rural workforce (surplus labour) can be caused both by the commercialization of agriculture or agrarian distress. Most importantly, caste and other social barriers are often key institutions that form barriers to skill accumulation and occupational mobility.

[8] Based on the literature examined so far, the type and effect of diversification would probably depend on the household's existing endowments and assets.

According to Jayaraj, caste, gender and access to land are influencing factors in the access to employment. As Saith suggests, the expansion of rural non-farm economy may increase rural social differentiation and income inequality. He argues that "concomitant agrarian differentiation and structural shifts induced by capital-oriented patterns of technological change have aggravated the situation by intensifying ongoing processes of rural marginalization and proleterization of resource-poor rural classes and communities" (Saith, 1992, 6).

On the other hand, Bebbington (1999) argues that it is the existence of non-agricultural livelihood options that enables the rural poor to remain in rural areas instead of migrating to the urban sector. Rural residence and the relationship of people to their land, he argues, is an integral part of their identity and a "critical determinant of their sense of being poor or not" (p.2026). It is important to underline the fact that Bebbington does not see agriculture as being an essential component of rural livelihoods. To this extent, Bebbington sees rural industry and the proletarization of the peasantry - another inevitable outcome of being 'non-viable'- as an opportunity for peasants to remain in rural areas and in their communities rather than migrating to urban areas.

This discussion draws out the class relations based on the means of production. Examining who does what, or the nature of production relations is an important indicator of class differentiation. This would shed important light on who may or may not be able to benefit from microfinance, and whether using microfinance to diversify income or shift to rural non farm production is a viable option or not.

Poverty reduction

Understanding the difference between poverty alleviation and poverty reduction is critical to the hypothesis of this study: <u>while poverty alleviation is the short term improvement of the capital endowments of the poor, poverty reduction is the long-term elimination of the dependency of the poor on social relations and vulnerability, with respect to changing environments</u> (Rajasekhar, 2004). Microfinance has been cited as a way to aid people to "work themselves out of poverty" (Fisher and Sriram, 2002). In order to analyze this claim, it is important to understand the factors that contribute to poverty and the nuances of how microfinance may or may not contribute to poverty reduction.

Although microfinance has been linked to women's empowerment and household social benefits, it is important to underline the fact that the goal of microfinance is to increase the incomes of the recipients, assuming that it would reduce poverty. While low incomes are an integral feature of poverty, conceptualising poverty primarily in income terms without taking into account the context, structural conditions and social relations at play in the cause and effect of poverty has been the failing of several economic development theories. As Mahajan notes, "access to [financial] capital is not a sufficient condition to improve the livelihoods of the poor" (Mahajan, 2007, 197). Providing credit as a poverty reduction strategy in a market structure is predicated on enhancing incomes through initiating economic activities, to be converted to asset building over an extended period of time. Moreover, micro credit is not really an asset-building strategy as is often a single intervention of a small loan for a short duration, with a strong emphasis on repayment, often insufficient to move household out of poverty (Mahajan, 2007).

Residual poverty, also known as exclusionary poverty, is an analytical framework that defines poverty as the inability of the poor to participate effectively in and benefit from their interactions with the market. Poverty exists either due to the lack of access to the market or the unfavourable terms on which the poor engage in the market either due to its imperfections or due to poor people's own limited capital (financial, human, physical, social and natural), endowments and access to assets (such as land, water and credit). Indeed, "the very poor and / or chronically poor may suffer from several overlapping and mutually reinforcing market failures" (Munro, 2008, 30). In so far as the exclusion from the market is concerned, the solution to poverty is to bring the market to the poor to bring them on the economic ladder (Sachs, 2005). Regarding the disadvantageous terms on which the poor engage with the market, strategies aimed at increasing the access of the poor to assets, increasing their endowments, enhancing their capabilities and augmenting their capital are seen as ways of addressing the exclusionary aspects of poverty.

In his discussion on 'old' and 'new' poverty, Rigg (2006) outlines mainstream perceptions of 'new' poverty as being a result of the engagement of people with the market and the state, as opposed to 'old' poverty which was a consequence of resource failures, inequalities and the distribution and productivity of land in an agrarian setting, and which was reproduced and inherited. However, in light of the diversification of rural livelihoods, increased mobility, migration and opportunities outside farming, Rigg argues that poverty is in fact a result of the separation of the poor from the market. Land for the rural poor has lost its 'strategic role' in this context, with skills for the poor taking precedence. He concludes by saying that pro-poor growth in rural areas should not be aimed at supporting small-holder farmers, as investing in agricultural activities would only increase inequalities, but rather governments should think of farmers as 'agrarian entrepreneurs' to become "commercially aware producers geared to the demands of the market" (Rigg, 2006). Dorward, A., J. Kydd, J. Morrison, I. Urey et. al (2004) endorse this perspective. In their view, the main role of agriculture is to stimulate rapid growth in the rural non-farm economy. However, arguments that advocate agrarian or rural entrepreneurship fail to take into account both structural barriers to accessing assets, resources and markets as well as the endowments, skills and knowledge needed for such ventures. As seen from the discussion above, agrarian demand and supply is influenced not only by domestic or national forces, but also international commodity markets. With commercial agricultural production being particularly expensive at a small scale and particularly prone to market fluctuations, advocating a reorientation towards market needs without adequate endowments and access to resources, amongst other factors, is problematic. Despite significant state support, the Green Revolution was arguably a rural entrepreneurship venture for large farmers. As with the case of the Green Revolution, those who may benefit from rural entrepreneurship would be those who are better endowed and able to take risks. Given the significant disparities in access and endowments, agrarian entrepreneurship would be a viable option only for the wealthy few.

Relational poverty derives from the concepts of social relations and social structures, i.e., the relationships of power between hierarchies. Poverty is believed to be caused by inequalities in social relations/ power structures (economic, political and / or social) mainly by perpetuating (and reproducing) structural inequalities, i.e., inequalities in the access to assets and resources[9]. In essence, therefore, relational poverty sees power relations as the principal barrier to equitable access to assets and resources, which in turn prevent equitable access to markets, and which in themselves are essential for viable livelihoods. Bebbington (1999) draws out the relational aspects of poverty, pointing out that the poverty question should not only be focused only on the poor: rather, it is as important to relate the changes in livelihoods among the poor to the changing assets of other actors. De Haan and Zoomers (2005) endorse this view, arguing that access to livelihood opportunities is governed by social relations, institutions and organizations, with power being an explanatory variable.

Relational and residual poverty, although conceptualized by somewhat opposing schools of thought are not mutually exclusive: exclusion from market and capitals resources and the barriers to accessing them due to inequalities in social relations are both contributing factors to rural poverty. Indeed, as Ellis points out, both approaches seek to examine the same economic system. "The incompatibility of the theories resides not so much in disagreement about the mechanics of the working of the market economy, but in the *meaning* attached to this working" (Ellis, 1988, 46).

Social inequalities can exist in the form of class relations, caste relations, ethnic relations, gender relations, language relations etc[10]. According to Razavi (2002, 35)

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[9] Bernstein (2007, 14) adds to this, saying that "poverty is produced by social inequality, by the social relations and divisions of class, gender, ethnicity, nation, and so on" highighting the multiple dimensions of social divisions.

[10] Social exclusion: Sen (2000) discusses the relational features of social exclusion, defining it as the social causes of individual deprivation. Referring to the context of capability deprivation, he states that being excluded from social relations can lead to other deprivations, and in this sense, social exclusion is an instrumental cause of capability failures. To examine the links between social relations and poverty requires a "typology of causation": "the real relevance of an exclusionary perspective, is, thus, conditional on the nature of the process that leads to deprivation" (Sen, 2000, 10). It is important to distinguish between social exclusion and exclusion from the market due to the lack of access to finance, the latter of which is the focus of this study.

"markets do not guarantee equality, justice or empowerment for those who are marginalized...the social forces that shape markets need to be pressured to do so". Rajasekhar (2004) goes further by saying that, in fact, markets often exacerbate inequalities, and that the notion of markets being neutral with all sections of society being equal players is fallacious. He states that "markets reflect and perpetuate inequalities in society on the basis of class, caste, gender and other social relations" (Rajasekhar, 2004, 10). Rajasekhar highlights the dangers of seeing the market as the main means for meeting basic needs, ignoring institutional barriers and intra-household inequalities.

Endowments, access to different forms of capital and resources, and people's capabilities in an open market system are elements that influence their 'comparative advantage' in that system. However, inequalities in endowments, access and capabilities are exacerbated in an open market system, leaving those less endowed and facing structural barriers far more vulnerable than others. Who does what, i.e., peoples livelihood strategies depend on what combination of these multiple factors they do or do not have access to. In a market oriented system, access to credit is but one part of the picture. Aghion and Morduch (2005) argue that microfinance does not challenge the existing economic relations and it is the wealthy who are able to exercise more power and benefit the most from microfinance[11]. In other words, microfinance can be seen as reinforcing existing power structures rather than breaking them down. Initiatives aimed at influencing rural livelihoods would therefore need to take into account the multiple factors influencing small-holder farmers. Moreover, the outcome of any intervention

[11] Kabeer (2001) cites Pahl (1989), who sees 'control' as the ability to make decisions about the allocation of resources. According to Kabeer and Thi (2000) as well as Rajasekhar (2002), the beneficiaries of mainstream financial credit for women have been the better-off sections of the population.

based on changing one aspect of rural livelihoods would depend on the nature of other influencing factors at play.

Access to finance and Inclusive Growth

Both the residual and relational schools of thought identify the lack of access to finance as a key aspect that defines and perpetuates poverty. The concept of 'inclusive growth,' on which India has based its national development model, identifies *financial* inclusion as the main pillar. Microfinance is seen as a tool to facilitate financial inclusion. Almost fifteen years after the neo-liberal macro economic reforms were initiated in India, the persistence of a large percentage of people below the poverty line is an indication that the 'trickle down' theory of wealth distribution does not work as smoothly as predicted. While the Government of India may argue that the percentage of people living below the poverty line has decreased over this time period, the fact remains that a significant percentage live in poverty. In addition, the presence of a large informal economy deprives the State of critical revenue. Inclusive Growth was designed by the planning commission of India as an attempt to ensure that the poor were included in the country's economic growth. It was also designed to 'formalize' the informal economy.

Financial inclusion (FI) is seen as a key pillar of the Inclusive Growth process. According to the deputy governor of the Reserve Bank of India:

> Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganised sector is believed to be acting as a constraint to the growth impetus in these sectors. Access to

affordable financial services - especially credit and insurance - enlarges livelihood opportunities and empowers the poor to take charge of their lives. Such empowerment aids social and political stability...Hence FI is considered to be critical for achieving inclusive growth; which itself is required for ensuring overall sustainable overall growth in the country[12].

- Text of speech by Smt. Usha Thorat, Deputy Governor, Reserve Bank of India at the HMT-DFID Financial Inclusion Conference 2007, Whitehall Place, London, UK on June 19, 2007.

Access to finance is indeed a structural barrier faced by the poor- both in urban and rural areas in India. The neo-liberal reforms that India initiated in the early 1990's included deregulation and privatization of national banks, which led to the closure of the large majority of rural banks in India. Thorat outlines the reasons that led to financial exclusion of a large number of rural poor:

Demand side factors:

- Low incomes/ assets to use as collateral
- Social exclusion- discrimination at the banks
- Illiteracy

Supply side factors:

- Higher transaction costs for banks
- Remote locations that were not seen as competitive by private banks

[12] Thorat outlines two forms of financial exclusion:

1. Not having a bank account
2. Exclusion from formal credit markets

- Unsuitable bank products for the poor
- Requirement of identity documentation

(Thorat, 2007)

The *availability* of credit does not necessarily ensure the *access* to credit by all members of society. While the availability of a good or service is a prerequisite for people to have access to it, access also includes the *ability* to partake of it if desired. In economic terms, while the availability of a good or service is supply driven, access is a function of both supply and demand. Thus while analyzing whether microfinance results in 'financial inclusion' it is important to examine whether people have access to it. Moreover, from a political economy perspective, it is important to go a step further and examine *who* has access to it, who doesn't and why not.

Indeed, literature suggests that microfinance does not always reach the 'poorest of the poor' and tends to benefit people that are better off (Harper, 2002; Fisher & Sriram, 2002). Hulme (2000) suggests that the nature of microfinance is such that poor people are not only excluded by others, but often exclude themselves as they are unable to save regularly or are constrained by other factors of poverty.

Given that microfinance requires regular financial contributions either as savings or repayments, microfinance may not be an option for small scale farmers with seasonal wealth. While microfinance may improve some people's access to finance, the poorest may not be able to participate in the microfinance process. Examining who has access to microfinance is thus a critical first step in examining whether microfinance can influence rural poverty reduction. While microfinance may facilitate livelihood diversification, what microfinance is used for would depend on a household's existing endowments, assets and capabilities as well as the political economy of the community. If used to build assets, microfinance may, over time, lead to increased capabilities to expand livelihood resources and production and reduce poverty. However, as discussed, microfinance does not exist in isolation, and taking into account other influencing factors that affect people's livelihoods is important to understand the dynamics of microfinance in a rural setting.

Analytical framework

A comprehensive analysis poverty reduction should examine how an intervention affects different actors differently (Bebbington 1999; Yapa 1998; Bernstein 2007). This analytical framework merges the theoretical frameworks of sustainable rural livelihoods, political economy, with an emphasis on access and barriers to resources; livelihood risks; social relations and poverty reduction.

> Given a particular *context* (of policy setting, politics, history, agroecology and socio-economic conditions), what combination of *livelihood resources* (different types of 'capital') result in the ability to follow what combination of *livelihood strategies* (agricultural intensification / extensification, livelihood diversification and migration) with what *outcomes*? Of particular interest in this framework are the *institutional processes* (embedded in the matrix of formal and informal institutions and organizations) which mediate the ability to carry out such strategies and achieve (or not) such outcomes.
>
> Scoones, 1998, 3

Scoones (1998) lists four different capitals (natural, financial, human and social) that he identifies as livelihood resources. While microfinance, through the provision of small scale financial services aims to bridge barriers of the access to financial capital, some organizations that deliver microfinance services aim at building social capital as well. Arguments around the need for training along with microfinance delivery discussed earlier highlight the human capital aspect of microfinance delivery. As this study is situated in a rural setting, it is vital to consider natural capital, both as a resource for rural livelihoods as well as an influencing factor on the outcomes of livelihood strategies.

Scoones argues that institutions and organizations, i.e., formal and informal *social structures*, are what influence livelihoods strategies and livelihood outcomes. These social institutions and organizations identify barriers to - and opportunities for - sustainable livelihoods and are central to understanding the relationship between livelihood resources, strategies and outcomes. Therefore, *access* to livelihood resources in the first place is the crucial first step for sustaining livelihoods. Examining whether people have access to livelihood resources and identifying the barriers that prevent them from doing so, is, therefore, an essential part of this study. Barriers to access may also be due to social structures, which is where the analytical framework and the sustainable rural livelihoods framework merge.

Bebbington (1999) classifies the different types of capitals as 'assets', and states that assets, or capitals, are not just the means of a livelihood but are also what give people the capability to be and act[13]. Assets, he argues, give people the capability to change the

[13] Capabilities, are thus based on people's endowments of different capital assets, as discussed by Sen (2000). In Bebbington's words:

> ...assets- or what I call capitals in this framework - are not simply resources that people use in building livelihoods: they are assets that give them the capability to be and to act.... The

rules that control their *access* to livelihood resources. Assets are thus vehicles for making a living and challenging the structures under which one makes a living. However, people's ability to expand their asset base is dependent on their interactions with and access to the state, market and civil society. Assets can be both endowed or acquired.

The state, market and civil society form part of the external forces that play a direct role in rural livelihoods. The analytical framework, therefore, specifically examines the access (and barriers) to these external forces. This is a diversion from Scoones' framework, where the state, market are looked at in terms of a policy and macro-economic context. While the context is examined in this study in more detail at the macro level, the present micro-level analytical framework of rural livelihoods sees value in examining the direct and active role of the state and the market as well as civil society in rural livelihoods, that may influence livelihood options, resources, strategies and outcomes.

While considering access, it is important to highlight *who* has access to what and who doesn't. This is an important first step in understanding who is excluded and what the barriers are. The terms of exclusion necessarily depend on what is being examined: for example, analysing financial exclusion would begin by considering who has access to what forms of finance, who doesn't, why not and how is this manifested?

De Haan and Zoomers (2005) reiterate Scoones, stating that access to livelihood opportunities is governed by social relations, institutions and organizations. They

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framework thus understands these assets not only as things that allow survival, adaptation and poverty alleviation: they are also the basis of agents' power to act and to reproduce, challenge or change the rules that govern the control, use and transformation of resources.

Bebbington, 1999, 2022.

emphasise power as the explanatory variable. Social institutions are a part of the analytical framework with control of resources and decision making the key elements.

So far, the analytical framework has remained parallel to the sustainable rural livelihoods framework, and therefore, the unit of analysis is similar: it can range from individual, household, and social groups. While integrating elements of political economy, by largely following the specifically agrarian political economy perspective by Henry Bernstein (2007), it is necessary to keep in mind the unit of analysis. While the political economy analysis is done based on occupational groups (for example, large, commercial farmers, small-scale farmers etc), the integration with the livelihoods framework allows individual and household level implications to be drawn.

Understanding 'who does what' is an important aspect of this framework, not only to place individuals and households in context, but also to examine the inter-relations amongst people in terms of production, labour and employment. This is important in understanding the socio-economic dynamics and power relations at play. As mentioned previously, changes in livelihoods do not occur in isolation, but in relation to others. This part of the framework draws out these aspects in finer detail. It is also an important prerequisite in understanding transformations in rural livelihoods; what's at stake and the implications of these changes.

Livelihood Strategies

As argued in the previous section, what people do is significantly influenced by the political economy (influenced, by production relations) and the choices available to them (influenced by structural barriers, endowments or assets, and the combination of capitals available to them). However, external factors such as weather and climate related issues, for example, may also have a significant impact on the choices people make. Livelihood strategies may include diversifying livelihoods, shifting from farm to non farm employment, migration etc.

Livelihood Outcomes

Often termed the "impact" of development initiatives or phenomenon, livelihood outcomes include a change in asset base, change in consumption and or production patterns, or a change in capabilities. However, with multiple influencing factors, identifying a direct cause-and-effect relationship between an initiative and an outcome may be extremely difficult to establish.

Hypothesis

Situating the rural poor in the larger context of the macroeconomic structures but also in relation to other actors and the shifts in assets is an important part of rural poverty analysis. The rural poor face multiple and overlapping constraints, with residual poverty perpetuated through social relations of production. While microfinance may indeed increase the access to finance for some, *who* has access to it as well as *what* it is used for may vary according to the political economy of a community. Given the nature and design of microfinance, this thesis argues that the while the rural poor may or may not have access to microfinance, the extent that it contributes to rural poverty reduction would depend heavily on what the poor are able to use microfinance for, particularly, whether they are able to overcome structural barriers and social relations. Given the small amounts of capital input, microfinance may be insufficient to significantly alter the social relations of production. However, if used to augment assets, microfinance may lay the groundwork for reducing poverty by increasing endowments for future generations, increasing household assets and, possibly, people's capabilities to convert assets into livelihood options and outcomes.

CHAPTER THREE

Methodology

In this study, theory informs research, and thus the study does not seek to construct grounded theory and is an *instrumental* case study. The type of case study attempted by the research is a *descriptive case study*, where the unit of analysis is predetermined (the household), where there are links that are established between the data and propositions, and where there is a criteria for interpreting the findings, as discussed further in the chapter.

As this study seeks to understand the depth of the impact on microfinance on the rural poor, the primary method of data collection will be *qualitative*. Qualitative methods allow for a more nuanced understanding of why the changes occurred, what the impacts of those changes are, whom it has affected and how. Thus a qualitative evaluation of the problem will allow for a more comprehensive understanding of the issues involved, with an understanding of the depth and breath of the problem studied and would shed light on the complexities and the dynamics involved. The qualitative data analysis will be done via deductive methods, where empirical data will be collected to test the hypothesis (Mikkelsen, 2005). Data collection will be done via multiple techniques, in order to examine all aspects of the phenomenon (Neuman, 2006).

Of the three main types of qualitative interviews: standardized, semi-standardized and un-standardized interviews, this study will be using semi-standardized interviews (Berg, 2006). While standardized interviews are formally structured and respondents are all asked the exact same questions, the questions are generally open-ended, unlike quantitative interviews where the questions are mostly closed (Mikkelsen, 2005). The disadvantage with having predetermined, fixed questions is that the interview process misses out on other information which may be vital to the topic being studied, and the researcher is unable to explore the depths of a response in order to get a broader understanding of the issues. Moreover, close-ended interviews increase the risk of an interviewer-bias and leaves no room for these biases to be addressed during the course of the interview. This could result in a risk of collecting misguided information and making false correlations. According to Mikkelsen, the advantage of fixed predetermined questions is that they make the data collected easier to compare. However, one could argue that they do not shed light on the uniqueness of the experience or other factors that may have influenced the response and thus the data collected. The semi-structured or semi-standardized interview also involves predetermined, open-ended questions based on themes or issues. However, the questions are not fixed, and as Berg puts it, " interviewers are...expected to probe far beyond the answers to their prepared standardized questions" (p.95).

While Participatory Rural Appraisal (PRA) would have been an ideal methodological technique for getting a solid, comprehensive and in depth understanding of the impact of microfinance on the rural poor, the time required to conduct such an appraisal would exceed the scope of this research study. However, elements of the PRA can be applied in this study, especially observation, awareness of indigenous technical knowledge, rapport building with the villagers and offsetting biases by self-critical awareness and keeping an open attitude (Chambers, 1992). Observation and discussions with key informants are a large part of the study.

The study is situated in two rural villages in the Indian state of Karnataka. The unit of analysis for different elements of the analysis will be the individual, household and social group. There were 22 people interviewed in the study, from different social groups, based primarily on caste and occupation. The villages were chosen based on the length of time the SHGs had been established in the villages, as a significant amount of time is necessary to observe the influence of microfinance on rural poverty. In both cases, the SHGs had been established over 10 years ago.

Indicators

The indicators used in the study include:

Who has access to microfinance?

1. **Caste:** caste differences have been highlighted in the literature reviewed as being a predominant factor of social differentiation in India. Caste barriers have been highlighted as being a traditional barrier in the access to financial capital. This indicator would shed light on whether this traditional barrier is an influencing factor in the access to finance.
2. **Occupation:** 'who does what' has been identified by Bernstein as a key indicator of social relations. It is also an indicator of people's livelihood strategies. Examining how occupations have changed or shifted as a result of access to microfinance is key in determining one of the livelihood outcomes or effects of microfinance on rural livelihoods.

3. **Access to other sources of finance:** While microfinance claims to provide or increase access to finance, this indicator will examine who has access to what forms of finance, and possibly on what terms. Answers may also shed light on the relative importance of microfinance, compared to other forms of finance, in people's lives. Whether those who have access to microfinance also have access to other forms of 'formal' financial services would also be an indicator of whether microfinance is indeed a tool for financial inclusion.
4. **How is microfinance delivered?** Who forms part of the microfinance groups? Who does not? Why not? This would shed light on whether inclusion or exclusion from microfinance groups is based on external criteria or people's own ability to participate in the process.

How are the financial services used?

1. **What are the microfinance loans and savings being used for?** This would shed light on whether the availability of savings and credit facilities influences livelihood strategies and what outcomes microfinance may have on people's lives.
2. **What are the other forms of finance being used for?** This would further indicate the relative importance of microfinance as opposed to other forms of finance in people's lives.

While the aim was to interview equal number of people who did and did not have access to microfinance, as well as from different castes, during the field study, a greater number of people who were part of microfinance groups were interviewed, as well as a greater number of people from lower castes. This was because:

1. The entry point into the villages was the NGO who helped facilitate the microfinance groups. Therefore, more members of these groups were willing to be interviewed than others.
2. People from 'lower' castes were more accessible than people from 'higher' castes. This was because the NGO worked predominantly with members from 'lower' castes and were welcomed by these households versus the 'higher' caste households. Also, on request, several people from 'higher' castes were unavailable for an interview.

CHAPTER FOUR

The Indian Context

Rural India

Rural India's transformation, invisible since the macroeconomic reforms of the early 1990's, was pushed to the spotlight in 2004. The national elections of 2004 saw a change in national leadership, which was primarily seen as a consequence of the rural vote. National newspapers argued that the change in national political power was a statement that the benefits of India's "shining" growth trajectory were not being felt outside its cities[14]. It was argued that while wealth increased exponentially in the cities, so did inequality. The realization that such a magnitude of India's population were excluded from the growth process but still had the power to change the leadership of the country sparked a renewed interest in rural India. Stories about agrarian distress and farmer suicides started to percolate through mainstream, urban media. For the cities and the central government, rural India was back on the agenda and a priority for the new government[15] (Planning Commission of India website).

> The underlying causes [of the current crisis] are stagnation in agriculture, increasing production and marketing risks, institutional vacuum and lack of alternative livelihood opportunities...There is an urgent need to expand the production base of agriculture with emphasis on small and marginal farmers

[14] "India Shining" was a slogan made popular by the previous national government, led by the BJP national political party. It was based on the high economic growth figures of India since the neo-liberal macroeconomic reforms of the early 1990's.

[15] Soon after the new government led by the Congress national political party came to power, they introduced policies of Inclusive Growth.

so as to integrate them with mainstream development. This calls for appropriate technological innovations, institutional alternatives and introduction of novel instruments of intervention.

-Radhakrishna report to the Government of India (2007)

According to the Expert Group on Agricultural Indebtedness (Government of India, 2007), India is facing an agrarian crisis which has both long term structural as well as short term manifestations and consequences. They argue that the fact that India is facing an agrarian crisis is based on three points:

1. Agriculture's declining contribution to GDP, currently around 20%
2. Declining production of food grains which has led to a significant decline in national food stocks
3. Declining productivity of agriculture, which employs around 60% of the population of the country.

Table 1: Growth of Sectoral GDP: Declining Growth in Agriculture

Year	Agriculture	Industry	Services
1980-'81 to 1990-'91	3.08	5.79	6.54
1992-'93 to 2005-'06	2.57	6.05	7.72

Source: CSO, National Accounts Statistics, Various Years, in Report of the Expert Group on Agricultural Indebtedness, Ministry of Finance, July 2007

Rural India, particularly agriculture, was a priority sector of the national governments in the 1960's and 1970's, with the advent of the Green Revolution and integrated rural development programs. The macro-economic reforms of the early 1990s initiated significant changes that affected the agrarian sector, such as the abolition and deregulation of marketing boards for agricultural goods, agricultural subsidies and State-run rural banks. The agrarian 'crisis' the country is experiencing today has been blamed partly for the neglect of the agrarian sector by government policy in the post-reform era and partly due to the retreat of the State in general (Satish, 2007). According to the expert group, the agricultural sector has suffered from neglect in technological innovations and extension, institutional availability of credit and poor rural infrastructure.

Table 2 : Profile of rural India today

Households with 1 hectare or less (marginal land-holding farmers)	66%
Farmer households in debt	48.6 %
Households without access to formal credit	73%
Percentage living below the poverty line	27%

Source: Speech, PC Chidambaram, Finance Minister, GoI (2006), Speech, Thorat (UK) and the Reserve Bank of India

In addition, long-term changes include environmental degradation and a severe scarcity of water in rain fed areas of the country: a characteristic feature of the large majority of the Indian rural landscape. According to the expert group, the lack of irrigation facilities compel farmers to borrow and invest in groundwater sources that soon run dry. Rapid urbanization, changing consumer preferences, and the liberalization of the Indian economy over the last 15 years have shifted patterns of agriculture towards commercial farming. While commercial crops require expensive inputs, the low availability of agrarian credit from formal financial institutions have led farmers to borrow from non-institutional sources, often at high rates of interest. Where the main source of irrigation is rain, commercial farming, or indeed any farming requiring expensive inputs, is a high-risk venture, and has resulted in crop failures in several cases, such as cotton farming in Andhra Pradesh. The declining terms of trade for Indian agriculture[16] and the fluctuations in the price of produce is another risk factor. This in turn has lead to declining yields and a high debt burden for farmers from 'informal' sources of finance, such as moneylenders, which partly explains the epidemic of farmer suicides the country is witnessing today (Reddy and Mishra, 2008).

While declining yields in food grains, a phenomenon influenced by shifting crop production towards other lucrative or niche-market options, low technological advancements and environmental degradation are sources of national concern for food self sufficiency it is only one manifestation of the agrarian crisis[17]. The other is the effect of this crisis on the lives of farmers themselves. The economic analysis of the crisis highlights the fact that while the contribution of agriculture to GDP is declining, currently at 20%, it employs around 60% of the country's population. While this highlights the low productivity of the agricultural sector, it also highlights a low and declining per capita income of those employed in agriculture[18] (Radhakrishna, 2008). However, as seen earlier, while the macroeconomic analysis may provide an overview of the condition of the agrarian sector, the sector is in no way homogeneous. It is important to examine how these macroeconomic realities translate into agrarian livelihoods, i.e., who is affected differently, how and why?

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[16] While this varies depending on the crop, the general trend of a decline in agricultural terms of trade post liberalization has been reported by the expert group of agricultural indebtedness (2007).

[17] An argument that this proportionally affects the food security of the Indian population would have to be treated with caution and examined in more detail. Food security refers to the *access* to food. While this is obviously dependent on the availability of food in a system, the availability of food alone does not necessarily imply access, particularly for the poor who may be unable to afford it (and may therefore be unable to meet their (and their household's) minimum nutritional requirements.

[18] According to the Planning Commission, "during 1997-2002, agricultural prices declined relative to prices not only of inputs but also non-food consumer goods. As a result ***purchasing power of agricultural incomes…decelerated***….Real farm incomes defined in this way not only show no per capita growth after 1996-97, but also increased variability" (Planning Commission, Mid Term Appraisal of the Tenth Five Year Plan, 2005, emphasis added).

Agriculture and inclusive growth

The rapid rate of growth in other sectors of the national economy in contrast with the stagnant growth of the agricultural sector highlights the weak links between the agricultural and non-agricultural sectors (Expert Group, 2007).

> The agriculture sector contributes only about 18 per cent of the total Gross Domestic Product (GDP), with more than 60% population dependence, resulting in low per capita income in the farm sector. Consequently, there is a large disparity between the per capita income in the farm sector and the non-farm sector.
>
> National Policy for Farmers 2007

In terms of the agrarian sector, Inclusive Growth strategies target two fronts:

1. Increasing production and yields
2. Increasing the productivity to improve farmer incomes.

According to the Chairman of the Planning Commission, the inclusive growth strategy with respect to agriculture seeks to address the "large productivity gap…if we can get farmers to adopt better cultivation practices, more rational use of inputs and so on, we can get a yield increase. The name of the game, at least in the short- to medium term, is to focus on that." The crux of the inclusive growth logic lies in the following sentence: "agriculture is very important because that is where a very large number of poor people earn their sustenance, so whatever is done to improve agricultural productivity gives them the opportunities to increase their incomes" (India Knowledge @ Wharton, p. 2).

According to the Planning Commission of India[19], inequalities in land distribution coupled with the ex-ante risk mitigation measures in agriculture (i.e., investing in less risky, lower yield crops) are factors that perpetuate rural poverty in India today. The Green Revolution in India was initiated with the same idea: the increase in crop production was vital to avoid famine and to increase the productivity of the agricultural sector. History has documented the negative consequences of this approach, which marginalized small scale farmers. Focusing only on agricultural productivity and per capita income overlooks the differentiated socio-economic landscape that exists even today. The following table highlights the disparities of landholdings in rural India, where 71% of farmers control less than a quarter of the arable land, while large landholders make up less than 1% of the farming population but control more than 11% of agricultural land.

Table 3
Changes in the Size Distribution of Operational Holdings and Operated Area: 1960-61 to 2002 -03

Category of Holdings	Percentage of Operational Holdings					Percentage of Operated Area				
	1960-61	1970-71	1981-82	1991-92	2003	1960-61	1970-71	1981-82	1991-92	2003
Marginal	39.1	45.8	56	62.8	71	6.9	9.2	11.5	15.6	22.6
Small	22.6	22.4	19.3	17.8	16.6	12.3	14.8	16.6	18.7	20.9
Semi-Medium	19.8	17.7	14.2	12	9.2	20.7	22.6	23.6	24.1	22.5
Medium	14	11.1	8.6	6.1	4.3	31.2	30.5	30.1	26.4	22.2
Large	4.5	3.1	1.9	1.3	0.8	29	23	18.2	15.2	11.8
All Sizes	100	100	100	100	100	100	100	100	100	100

Source: (NSSO) Report of the Expert Group on Agricultural Indebtedness, 2007.

[19] Planning Commission of India, Report of the Steering Committee on Rapid Poverty Reduction and Local Area Development for the Eleventh Five-year Plan (2007-2012)

According to Cobridge (1982), not recognizing the *social differentiation* that exists within both the rural and the urban sectors portrays a simplified analysis of the situation. Assuming that the benefits of increased agricultural productivity will necessarily translate into income augmenting opportunities for all, particularly the rural poor engaged in agriculture, overlooks several issues, including:

1. That the poor have or will have access to an amount of land significant enough to participate in and be competitive in the market[20]
2. That this land is conducive to agriculture and that a source of irrigation is accessible.
3. That they have the skills, resources and abilities to compete against larger farmers, against imports and against large agro corporations.
4. Access to the required inputs are affordable, (both in terms of monetary and the opportunity costs)
5. An increase in profits or agricultural productivity will necessarily translate into higher wages for agricultural labourers

This last point is of particular importance, given that most of the rural poor engaged in agriculture are small scale and marginal farmers who most often work as agricultural wage labourers as well, sometimes as the main source of income and sometimes to supplement it. According to the poverty reduction report of the Planning Commission, the lack of access to agricultural services, including extension, credit, insurance and markets, is not just a feature of small and marginal farmers today, it was characteristic even during

[20] Land fragmentation in India is a well known issue, with the majority of the rural poor small- or marginal land holders, or landless.

the time of the Green Revolution, when agriculture was a significant contributor to the economy. Moreover,

> One of the causes as well as consequences of poverty and backwardness is inadequate access to all these forms of capital [natural capital, financial capital, social capital and human capital]. Thus *to look at financial inclusion in an isolated way is problematic.*
>
> - Rangarajan report

A key factor in understanding the issues of agricultural finance is who actually delivers the services. While previously in India, the state had assumed some responsibility for credit delivery, a significant amount of rural credit delivery today remains in the hands of local money lenders. The Indian government as well as commercial financial institutions claim that unregulated, private money lending at the local level is done at exorbitant interest rates, contributing to a high level of debt. The argument for large scale commercial delivery of agricultural financial services is that institutionalized financial service provision would reduce interest rates for farmers' loans while encouraging them to mobilize their savings and investments.

Table 4: Relative Share of Borrowing of Cultivator Households from Different Sources

Relative Share of Cultivator Household Borrowing from Different Sources						
Sources of Credit *(Per cent)*	**1951**	**1961**	**1971**	**1981**	**1991**	**2002**
Non-Institutional	92.7	81.3	68.3	36.8	30.6	38.9
of which						
Money Lenders	69.7	49.2	36.1	16.1	17.5	26.8
Institutional	7.3	18.7	31.7	63.2	66.3	61.1
of which						
Cooperatives Societies/ Banks	3.3	2.6	22	29.8	23.6	30.2
Commercial Banks	0.9	0.6	2.4	28.8	35.2	26.3
Unspecified	-	-	-	-	3.1	-
Total	100	100	100	100	100	100

Source- Reserve Bank of India: Golait- Current Issues in Agricultural Credit in India RBI Paper 2007

SHG Bank Linkage Programme

The Self-Help Group-Bank Linkage Programme is an initiative of the government of India that aims to link local self-help groups (groups of about 15-20 women) to formal financial institutions or banks[21]. NGOs play a crucial role in helping the SHGs form and facilitating the 'linkage' with the banks[22]. The partnership of commercial banks and other private financial organizations (known in India as Non-Banking Financial Corporations, NBFCs) with the national, state and local governments has been seen as a way of bridging the gap between the concerns and constraints of the private sector and the interests of the public sector in poverty reduction.

[21] While Self-Help Groups are geared towards women for empowerment related issues, the debates around women's empowerment are beyond the scope of this study.

[22] According to Fisher and Sriram, "...no account of micro-finance practice in India is complete without also considering the development agendas of the organisations providing or facilitating microfinancial services. These agendas include poverty alleviation at their core but also encompass livelihood promotion, empowerment (particularly of women), building people's organizations and changing the institutional environment." (Fisher and Sriram, 2002, 263).

Lending to a group is seen a key to mitigate the risk of a member defaulting on a loan and generating group collateral. Typically, banks lend money to the SHG group, which in turn lends the money to individual members. Thus if one member defaults, the group as a whole bears the consequence. As members of SHGs are usually women from the same village or community, peer pressure is seen as a way to ensure repayments of all members.

Previous experience with government based rural credit highlighted the fungability of loans, where people would use their loans for purposes other than agriculture. In an attempt to improve on this, the SHG-Bank linkage programme is designed in a way that allows members to use the loans for any reason as long as the group members approve. In contrast, microfinance loans by Grameen Bank insists that loans be used for productive purposes (for investing in micro-enterprises) and demands compulsory savings as a condition of accessing loans. (Fisher and Sriram, 2002).

This study aims at understanding how the SHG Bank Linkage program affects rural poverty in both an agrarian and non-agrarian setting. It examines who it affects, in what way, with what outcome. The analysis will look at what these outcomes mean for the lives of the people themselves, for local and national development in relation to the socio-economic and political environment.

CHAPTER FIVE

Case Study: Microfinance in Two Villages in Karnataka

The two villages studied are located in the Mulbagal administrative region of Kolar district in Karnataka. Originally known as the "tank"[23] district of the state, an overwhelming point that was observed and raised by nearly everyone interviewed was that the region had dried up considerably and the biggest problem in the region was the severe shortage of water. The main staple crop grown in the region is Ragi, a type of millet. Commercial crops grown included tomatoes, onions and other vegetables as well as mulberry leaves.

Kolar is also known as "the land of milk and silk." Milk cooperatives are common in the area and provide a government-run marketing option for those with milk producing livestock, i.e., cows and buffaloes. Silk production, or sericulture, is a lucrative, commercially oriented occupation, and is often done in conjunction with other farming. Sericulture, however, is an occupation primarily in the hands of large scale, richer farmers. This is because the mulberry leaves required for the silk worms to eat are extremely water intensive and require enough available land and irrigation to grow.

The villages were situated relatively close to the district capital town (Kolar) and about 80 kilometres from the state capital, Bangalore. Both villages were chosen because they had SHGs established over 10 years ago. Studying an agrarian and non-agrarian village would also shed light on whether microfinance affects different types of rural poor differently (based on occupation). There was a significant observable difference in the

[23] Small lakes or large ponds

occupation of the inhabitants of the two villages. The first village visited, Atikonte (Village A), was largely an agrarian village, with most interviewees engaged in agricultural labour either on their own farms or the farms of others in the village. In second village, Batalabhavanahalli (Village B), most people interviewed stated that they worked in construction, specifically in breaking large slabs of granite stone into smaller pieces for construction. The construction business was owned by someone outside the village. The large slabs of granite were brought into the village from a nearby quarry and the broken bits were transported to larger cities.

Table 5: Villages studied

	Village	Occupation
A	Atikonte	Agriculture
B	Batalabhavanahalli	Daily wage labourers in a stone quarry

The main civil society organization or non-governmental organization (NGO) working in the villages is Grameen Mahila Orkuta. Primarily a rights-based organization, the NGO also helped facilitate the linkage between the Self-Help Groups (SHG) and formal, commercial banks in the region. They also helped form the SHGs. While there were other SHGs in the villages, they did not seem to be active at the time of the study. Many households in Village 2 were also recipients of a government led housing scheme, the Indira Awas Yojna where households were receiving grants to build (concrete) houses.

As the entry point into the village was the NGO, most people interviewed were associated with the Self-Help Groups, either as members or male family members of SHG members. A limitation of this study is that it was not possible to interview an equal number of SHG members and non-members, which may have resulted in a sample bias. Another limitation of the study is that most interviewees were women. Information on loans was collected on a household level, i.e., all loans taken by the household.

As discussed in the literature review, the term 'rural' is not synonymous with poverty. Evidence of large differences in wealth was observed in both villages studied: not only between 'higher' and 'lower' castes but also between 'lower' caste households. The literature review also highlighted the fact that rural does not necessarily mean 'agrarian' and indeed there was ample evidence of non-agricultural rural work, particularly in Village B.

Table 6: Findings: key elements

Village A: Atikonte

SHG membership		Caste	Occupation	Length of membership	Access to finance	Purpose of loan taken	Land	House
SHG members	A1	SC	Agricultural labour	1 year	Moneylender	Typhoid (health)		Thatch
					Government scheme women's group	Child health		
					SHG	Doesn't want loan		
	A2	SC	Agricultural labour	1 year	SHG	Festival	Landless	Small concrete
					Commercial bank	Son's wedding		
					Villagers	Same wedding		
	A3	UC	Work on own farm+ agricultural labour for others+tends sheep	10 years	SHG	Sheep	2.5 acres(2 acres dry, 0.5 acres irrigated)	Concrete
					SHG	Household expenses, fertilizer		
					SHG	Oxen		
	A4	SC	Husband is court clerk	15years	SHG	Sheep		Big concrete
					SHG	House		
					SHG	Cow		
	A5	SC	Doesn't work due to health problems & old. Sometimes agricultural labour during harvest seasons.		From Big farmer	Seeds		Concrete
					People's Land Development Bank			
					SHG	Sheep		
					SHG	Sheep		
					Moneylender	Wedding		
	A6	SC	Works on own farm+ agricultural labour for others+odd jobs	15 years	SHG	Sheep	1 acre+1.5 acres bought with loans	Concrete
					SAST Corporation	Land		
					SHG	Land		

Village A: Atikonte

SHG membership		Caste	Occupation	Length of membership	Access to finance	Purpose of loan taken	Land	House
Not members of SHG	A7		Works on own farm & tends cows & some construction	No (husband doesn't want her to)	Would like a bank loan (unclear)	Wants to buy a cow by putting land as collateral, but hasn't worked out	1 acre	Small concrete
	A8	SC	Agricultural labour + cow business	2 years in a different SHG (Stri Shakti)	Moneylender		Landless, houseless-living in someone's shed	Very small concrete shed
					Moneylender	Cow		
					SHG	Cow		
	A9	SC	Construction worker	-	Never taken any loan since husband drinks and she would not be able to repay		Unclear	Concrete but bare
	A10	Unclear	Own land work & cow tending	-				Concrete
	A11	UC	They are landlords and have their own farm business+ silk farming	-			At least 11.5 acres	Very big concrete house on Upper caste side

UC: Upper Caste

SC: Scheduled Caste (lower caste as recognised by the Government of India)

Village B: Batalabhavanahalli

SHG membership		Caste	Occupation	Length of membership	Loan	Purpose	Land	House
SHG Members	B 1	SC	Stone breaker	15 yrs	Moneylender	Small		Concrete
					5 Bank loans	Borewell (land as collateral)		
					SHG	Daughter's wedding	8 acres	
					Village	Illness		
SHG Members	B2	SC	Stone breaker/ agricultural worker	15 years	Unclear	Land for house		Now concrete
					SHG (to supplement govt program	Build house		
					Advance from construction owner	Food		
SHG Members	B3	SC	Cowherd (husband is a stone breaker)	15 years	SHG	2 Cows	1 acre dry	Brick
					Moneylender	Health		
SHG Members	B4 (male)	SC	Construction worker	Wife in SHG for 10 years	Moneylender	Health	2 acres	Concrete
					SHG	To get son a job		
					SHG	To get son a job again		
SHG Members	B5	SC	Stone breaking	15 years	SHG	Cow?	2 acres	Concrete
					SHG	Sheep		
					SHG	Sheep- 6		
SHG Members	B6	SC	Stone breaking/ agricultural work (husband works in construction and loads stones on a tractor)	10-15 years	SHG	Grandma's health	I acre dry	Concrete
					SHG	Husband's health		
					SHG	Cow		
SHG Members	B7 (male)	UC	Works on own farm / stone cutting	Wife is a member	Bank	Water tank for agric		Big concrete painted
					Villagers	Son's wedding		
					SHG	No loan taken yet		
SHG Members	B8	UC	Shopkeeper	15years	Bank through SHG help	Petty shop business	Land	Big concrete painted

Village B: Batalabhavanahalli								
SHG membership		**Caste**	**Occupation**	**Length of membership**	**Loan**	**Purpose**	**Land**	**House**
Not members of SHG	B9	SC	Agricultural labour	-	Moneylender	Not yet		Thatch
	B10	SC	Agricultural labourer / stone breaker	-			Landless & rented house. Not enough to eat	Semi concrete
	B11 (male)	Unclear	Stone breaker	-	Bank	Build house	I acre	Small concrete

UC: Upper Caste

SC: Scheduled Caste (lower caste as recognised by the Government of India)

Note: SC and ST refer to Scheduled Castes and Scheduled Tribes, which are lower castes.

While social mapping would have been another ideal method for examining the socio-economic hierarchies in the villages, such a method would require significant time and participation by many members of the village and was unfeasible during the field study. Information on this was gathered via key informant interviews and observation. Discussions with key informants revealed that residential areas in the village were divided by castes, suggesting that caste still remains a predominant social differentiator.

CHAPTER SIX

A Critical Examination of Microfinance in the Two Villages Studied

Design of SHG-Bank Linkage

One of the unique features of the SHG bank linkage program observed in the field was that access to loans does not depend on the type of employment the borrower is engaged in, unlike previous government run credit programs. Villagers from both the agricultural and non-agricultural villages were able to obtain loans that were not dependent or conditional on the type of work they were engaged in. This is one aspect that makes the SHG-Bank linkage program conducive to changing rural livelihoods where households are engaged in a range of agricultural and non-agricultural activities. Secondly, members were not obliged to use loans for productive purposes. One of the problems encountered by previous government-run agricultural credit programs was the fungability of the loans, where loans used for household expenditures rather than agricultural production. In the villages studied, while members of the SHG would have to make their case to the group, loans were given for personal use, such as health or consumption, as well as productive investment, such as purchasing livestock or building houses, as outlined in the tables above. In terms of what the loans could be used for, the SHG-Bank Linkage program is thus much more flexible and 'needs-based' than other forms of formal credit.

According to the literature reviewed, it was argued that microfinance is not suitable for agrarian settings, as microfinance requires monetary deposits at regular intervals. It was argued that since farmers have available cash only at seasonal intervals during harvests, microfinance is not conducive to agrarian livelihoods. This did not hold true in the agrarian village studied, as:

1. The members of the SHG groups were small-scale farmers engaged in mostly subsistence farming on their own land. Those involved in commercial farming were generally higher caste, wealthier farmers who were able to take commercial loans from banks and were not part of the SHG groups
2. The small scale farmers were also agricultural labourers, and were employed for a few days a week in large farms during the non-rainy season or throughout the year if their land was too dry to work on. Therefore, in addition to their own farm, they were receiving ***wages*** that allowed them to contribute on a regular basis.

Repayment

There was a heavy emphasis on repayment by the NGO, and by extension, the leader of the SHG who was charged with collecting repayments. Regular biweekly savings contributions were also a strict requirement of remaining a member of the SHG. These two factors had several observed repercussions for the SHG Bank Linkage Programme in the two villages studied:

The repercussion that has the greatest implication for rural poverty reduction was that the members of the SHG were inevitably the better-off sections of the lower caste people in the villages. *The emphasis on bi-weekly savings ended up excluding the poorest* *from the villages*. During interviews with extremely poor non-members, they mentioned that they were not part of the SHGs because they knew they wouldn't be able to make a regular contribution. The self-exclusion from microfinance groups is a point that has been highlighted by Hulme (1996). Of the non-members of SHGs interviewed in both villages, the people from 'lower' castes were also landless labourers. One woman said that as her husband was an alcoholic and sells everything that comes into the house, including their food grains to buy alcohol, she would not be able to repay any loan she took and she knew about how strict the group was regarding repayments and contributing savings[24].

Another effect of the strong emphasis on repayments was the continued existence of and reliance on moneylenders. Contrary to statements reviewed in the literature, moneylenders in the two villages studied offered the same rate of interest on loans as the SHG and were more flexible regarding repayment. *One of the interviewees mentioned the fact that she preferred the moneylenders as they were more flexible.* A possible reason for the low rates of interest from moneylenders may be the competition from SHGs and rural banks, but this was not explored in the study.

Savings

According to Mayoux, micro savings divert resources away from consumption and investment. The findings relating to this statement are somewhat ambiguous. Women in SHGs mentioned saving small amounts of money from their household expenditures to deposit as savings in the biweekly SHG meetings. Therefore, while the amount would otherwise be used for household consumption, it is unclear whether it would be saved or

[24] A direct quote is not provided as the interviews went though translation in two languages- from Kannada to Hindi and from Hindi to English. Any quote would therefore capture what was said but would not be the exact words of the interviewee.

invested. Moreover, those women who knew that they would be unable to save, i.e., the poorest of the village, were not part of the group. The extent to which the savings compromised consumption was unclear and likely varied by household.

However, by design, SHG *savings cannot be withdrawn as long as a member is part of the group*. The group savings are pooled together and used as collateral against the loan from the bank, and the bank usually lends the group three times the amount that is deposited as savings. The group then divvies up the loan to members as they deem appropriate. In many cases, long term members had collected substantial savings, but never used any of it. Most importantly, *members could not use their savings to pay off their loan*. Therefore, the potential of obtaining further loans is a greater incentive than withdrawing savings, particularly for long-term members, of which there were several. It is also another layer that excludes the poorest from long-term benefits of microfinance via this program.

Who has access to microfinance?

Based on the findings listed above, the following table groups the socio-economic profile of the villages studied. Note, the categories of 'non-poor', 'relatively poor' and 'extremely poor' are used for the purposes of this study to mark the substantial difference between households of 'lower' caste. The classification is based on the data collected, including interviews and observation. The study recognises the multiple dimensions of poverty and is thus cognisant of the limitations of the classification based on the indicators listed below.

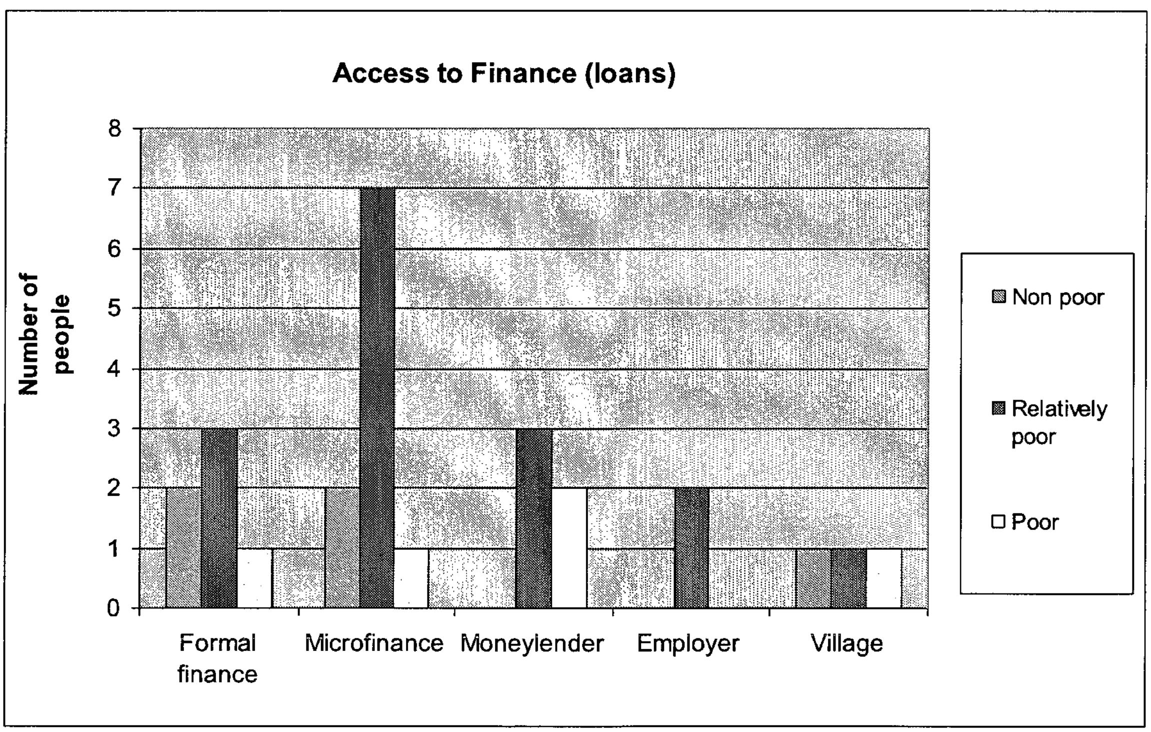
Table 7: Socio-economic profile of villages studied

	Upper Castes	Lower Castes	
	Non - poor	**Relatively poor**	**Extremely poor**
Housing	Big, concrete houses	Smaller concrete houses, partly thatched roofs in some cases	Tiny one-room houses or rented accommodation
Land ownership	Larger landholdings	Small and marginal landholdings (around 1 or 2 acres)	Landless
Occupation	Men work in the fields with their hired labour while women do some agricultural support work at home (cleaning produce), may engage in sericulture and engage in mainly domestic chores	Work on their own land & as agricultural labourers or daily wage workers- both men and women	Agricultural labourers or daily wage workers- both men and women
	Commercial agricultural production	Subsistence agriculture on their own farm and commercial agriculture where they work as labourers. Wealthier may hire agricultural labourers during harvest	
		Construction/ Stone breaking	Labourers
Assets and resources	Larger number of resources such as tractors and water via bore wells. Livestock such as cows and buffaloes	Some small scale resources and may own livestock, more goats, sheep and chickens and a few cows/ buffaloes	Hardly any assets/ resources
Microfinance	Most are not part of microfinance groups.	Microfinance group members	Most are not part of microfinance groups
Other forms of finance	Borrow from banks	Borrow from moneylenders, employers and banks	Borrow from moneylenders and villagers
Education	Children go to school	Children go to school	Children go to school

***Note:** the terms 'relatively poor' and 'extremely poor' are based on the descriptions in the table to describe the significant differences that exist between households of 'lower' castes, for the purpose of this study. A limitation of this study is that the above indicators* *are not a comprehensive indication of poverty. The terms are used to represent relational rather than absolute poverty.*

While members of microfinance groups in the villages were indeed the better off sections of the village society as outlined by Kabeer (2001), it must be specified that they were the better off sections of the lower castes of the village, *not* of the general village population. The upper caste, wealthier women did not participate in the SHGs partly as their husbands were able to get larger loans from other sources and partly due to social norms, where their husbands did not want to attend the meetings. When asked why, they responded by saying it was because the meetings were held at night. This fact, incidentally, also prevented some other lower caste women with small children from attending the meetings.

Table 8: Who has access to what form of finance



Financial inclusion and access to financial capital

From the chart above, it is evident that there are multiple and overlapping forms of finance available at the village level, both formal as well as informal finance. Sources of finance documented include banks (formal finance), microfinance, moneylenders, employers and other village members. While the majority of the SHG members are relatively poor they are also the ones with access to the most diverse range of financial sources, including, to a lesser extent, formal finance. Moreover, those who access microfinance loans include the non-poor, who also have access to formal sources of finance. In the context of these two villages therefore, while microfinance facilitates and deepens formal financial integration, it is not a comprehensive solution to formal financial inclusion.

The SHG Bank linkage program provides access to formal finance through a group setting, therefore, considering the social aspects of a self help group, it may be argued that the SHG bank linkage program provides access to *semi*-formal credit, with group decisions and liabilities the main crux in access to finance between formal financial institutions and the individual. Who can get loans for what are vetted by the members of the group and are not free from social relations.

Examining what the members did with their access to financial capital sheds light on their capabilities to convert financial capital into livelihood outcomes. In the case of the two villages studied, this includes:

- Large scale personal expenditures / Supplementing household finances
- Livelihood diversification (and / or) asset creation

Table 9 a: Various types of loans taken for different purposes from different or overlapping sources

Formal finance	Microfinance	Moneylender	Employer	Village
Augmenting rural infrastructure (water sources)	Augmenting asset base- livestock	Augmenting asset base- livestock		
Land	Land			
House construction (part)	House construction (part)			
Business	Jobs			
Wedding	Wedding	Wedding		Wedding
	Health	Health		Health
			Consumption	Consumption

Table 9 b: Various types of loans taken for different purposes from different or overlapping sources

Purpose of loan	Non-poor	Relatively poor	Extremely poor
Augmenting rural infrastructure	Commercial bank	Commercial bank	
Land		Big farmer (seeds) People's land development bank (non-commercial) SAST land cooperation SHG	
Augmenting assets (livestock)	SHG	SHG	Moneylender SHG
House construction		SHG Bank	
Business	Commercial bank		
Jobs		SHG	
Wedding	Village members	SHG Moneylender	SHG Commercial bank Village members
Health		Moneylender Village members SHG	Moneylender Government program
Consumption		Employer	Villagers (grant, not loan)

Supplementing household finances

One of the arguments in favour of microfinance in the literature, and indeed of development literature in general, is that microfinance provides access to finance, which in turn will be invested either in productive assets, enterprise or production. This was not completely the case in the villages studied. Members were able to take loans for personal as well as productive purposes. Loans were often taken to supplement household finances, particularly during times of financial stress, particularly at the time of weddings or illness. In this case, the loans were used in a vulnerability reducing[25] manner. However, it must be noted that those who took microfinance loans for personal expenditures also borrowed from moneylenders and villagers for the same event. Microfinance, therefore, is but one of the sources of finance in these occasions and has not eliminated the use of informal sources of finance.

Livelihood diversification and building assets

People employed in agriculture used their loans differently from those engaged in non-agrarian work. While SHG members from Village A mainly invested in livestock (encouraged strongly by the NGO), members from Village B used their loans to supplement government funding to build concrete housing. This observation highlights the fact that while the microfinance loans themselves were insufficient to build housing, government funding for housing construction too, was insufficient. The two sources of funding while complementing each other were symbiotic, and both were needed to construct a house.

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[25] Kabeer (2002) identifies the "vulnerable non-poor" as people who are marginally above the poverty line but whom any crisis, such as illness or other financial shocks may push into poverty.

Changed livelihood strategies and capabilities

The low availability of water, the proximity to the growing State capital and the availability of non-farm work were some of the main discernable factors that influence livelihood diversification in the two villages studied. For households in Village A, households were shifting from own farm work to agricultural wage labour on the farms of large commercial farmers who had irrigated fields. It was this semi-regular source of income that enabled members of the SHG to make their bi-weekly required savings deposit.

In this context, while microfinance did not discernibly contribute towards the shift in livelihoods away from own farm work to agricultural labour[26], in some cases it eased the transition by providing supplementary financial capital to smooth household expenditures. In others, where microfinance was used to purchase livestock, microfinance did enable diversification and enhanced the capabilities of households to convert their new livestock assets into productive resources. A government-run milk cooperative in the area helped with this as it provided a stable marketing option for those with cows and buffaloes. However, one person cited animals dying from disease, becoming a liability rather than an asset.

However, in both villages, when microfinance was used for building assets, it contributed towards a long-term increase in the household's *endowments*.

[26] As discussed previously, it was not the occupation, but the ability of a person to forgo a certain amount of disposable income in the form of 'savings' in order to obtain a loan that allowed them to be part of the SHG.

Structural barriers

Other than in one case where microfinance was used to purchase land, microfinance in the agrarian village was not used to enhance agricultural production. In this respect, microfinance was not used or not sufficient to overcome structural barriers to viable agrarian production. The main structural barriers to agrarian production in Village A included:

1. Access to irrigation/ water: the severe lack of water in the region was a factor that was cited by nearly every person interviewed. While the lack of water in the region was taking a toll on subsistence farming or crops for consumption, a large commercial farmer cited the fact that his tube-wells were drying up, and each successive new well tried up shortly after drilling.
2. Land: most 'lower' caste households in Village A owned marginal land-holdings, i.e., one or two acres which was insufficient to grow commercial crops to benefit from economies of scale. The lack of water in the region meant that people were finding it difficult to use the little land they owned even for consumption crops. Smallholder farmers also cited the high risk of crop disease and volatile prices for commercial produce as deterrents for growing commercial crops.

Social relations

Although difficult to determine the "impact" of microfinance in a community, there was no discernable change in social relations between members of 'lower' castes and 'upper' castes, nor was there a change in production relations. Members of the SHG group in Village A still worked as agricultural labourers on the fields of large farmers, despite diversifying their livelihood and despite purchasing livestock. In fact, it is the income received from wage labour that allowed them to contribute to the SHG on a regular basis. Except in a few cases, livestock supplemented the livelihoods of agrarian households and was not the main source of income. Large farmers still owned large amounts of irrigated land used for commercial crop production, and microfinance was not used to augment member's own land or change their crop production.

CHAPTER SEVEN

Conclusion

The key purpose of this thesis was to examine whether, how and to what extent microfinance contributes to poverty reduction in rural settings. Based on the literature examined, it was hypothesised that while microfinance may indeed increase the access to finance for some, whether the poor have access to it, as well as what it is used for, may vary according to the political economy of a community. This would in turn affect how and whether microfinance is able to contribute towards poverty reduction. Chapter six comprehensively analysed the case study findings with respect to the research question, the literature examined and hypothesis reached.

While evidence suggests that microfinance via the SHG Bank Linkage Programme has been successful in providing its members access to financial services,

- it is not the only source of finance in the villages studied, and is often coupled with loans from moneylenders or government grants;
- it has not eliminated the existence or use of other informal financial sources;
- it is more flexible than previous rural credit which prevents the fungability of loans but is inflexible in its repayments and savings requirements, making it an option for the better off poor or vulnerable non-poor;
- it is conducive to a rural setting, unlike what was predicted in the literature examined.

As seen Chapters five and six, microfinance is mainly used for supplementing household finances, as well to diversify livelihoods and build assets.

Who has access to microfinance?

In the case of the two villages studied, members of lower caste households have access to microfinance, which is a significant achievement in terms of overcoming traditional caste barriers. However, as discussed by Kabeer (2001), members of microfinance groups in the villages were the better off sections of the village society. It must be specified that they were the better off sections of the lower castes of the village, *not* of the general village population. While most of the members of the SHGs were from 'lower' caste households, extremely poor households were generally absent from the groups. Therefore, while the program has succeeded in overcoming traditional caste barriers, the extent to which the economically poor are able to access microfinance is limited.

While financial services offered through the SHG-Bank linkage program include both savings and loans, SHG members were not able to use their savings while they were part of the group. Thus, by design, the emphasis on bi-weekly savings ended up excluding the poorest of the villages as they were unable to make regular contributions to the SHG. While the SHG-Bank Linkage program in these villages has overcome caste barriers, it has inadvertently created new economic ones to access microfinance[27].

Unlike other microfinance programs, access to a loan via the SHG-Bank Linkage Program does not depend on the type of employment the loan-taker is engaged in. Villagers from both the agricultural and non-agricultural villages were able to obtain loans that were not dependent or conditional on the type of work they were engaged in.

[27] In terms of India's national development strategy, evidence suggests that the SHG Bank Linkage Program helps deepen financial inclusion by linking members to formal financial sources such as commercial banks. However, members could only access the banks via the group and with the facilitation of the NGO. As the loan is still based on informal, group-based social decisions, it can be argued that microfinance via the SHG-Bank linkage program is a form of *semi*-formal finance.

This is one aspect that makes the SHG-Bank linkage program conducive to changing rural livelihoods where households are engaged in both agricultural and non-agricultural activities.

However, and most significantly, the emphasis on bi-weekly savings and regular contributions meant that only those households with a steady source of income were able to access microfinance. Nearly all households that participated in the SHG-Bank Linkage program were engaged in some form of wage labour. A regular source of income as well as the ability to forgo the opportunity cost of bi-weekly savings seemed to be the contributing factors to who could participate in the groups. Therefore, it is the existence of wage labour that gave SHG members the regular source of income that allowed them to make their bi-weekly required savings deposit and be part of the group.

What is microfinance used for?

As discussed in chapter six, microfinance loans were used for personal as well as productive purposes. Loans were often taken to supplement household finances, particularly during times of financial stress, particularly at the time of weddings or illness. In this case, the loans were used in a vulnerability-reducing manner, reducing the potential of households sliding into or deeper into poverty in the face of a financial shock.

Chapter six also analyses the use of microfinance with respect to livelihood diversification. Evidence suggests that while microfinance did not discernibly contribute towards the shift in livelihoods away from own farm work to agricultural labour, in some cases it eased the transition by providing supplementary financial capital to smooth household expenditures. In others, where microfinance was used to purchase livestock, microfinance did enable diversification and enhanced the capabilities of households to convert their new livestock assets into productive resources.

As discussed in the literature, small scale farmers often face multiple and overlapping constraints, with short run household decisions often imbedded in social relations of production. In the case of the agrarian village studied, while the environmental risk and constraint of water scarcity was a significant deterrent in investing in small-scale agriculture, the loans themselves were insufficient to make large-scale agrarian investments, such as land or tubewells. Price fluctuations in commercial produce such as vegetables, in addition to the substantial costs of inputs, were further deterrents for investing in commercial agriculture. The scarcity of water, the proximity to the state capital and the availability of non-farm work were some of the main discernable factors that influenced livelihood diversification in the two villages studied. Households in the agricultural village were transitioning from their own farm work to agricultural wage labour on the farms of large commercial farmers who had irrigated fields.

Implications for rural poverty reduction

Literature suggests that livelihood diversification is based on class relations, with only wealthier households able to benefit due to their greater asset endowments. Bernstein (2001) states that poorer peasants most likely to shift to wage labour, middle peasants engage in wage labour and other income diversification activities, while richer peasants would diversify to wealth accumulating activities. Evidence from this study shows that this holds true in the case of microfinance, where 'middle peasants' or the relatively poor were able to purchase assets and work on the fields of larger farmers or in construction. In this respect, while microfinance may not have been the cause for class differentiation, it was certainly unable to challenge the social relations of production.

The fact that wage labour is a significant factor in determining who does or does not have access to microfinance makes a contribution to the literature on microfinance and poverty reduction. To reiterate, while poverty alleviation has been defined as the short term improvement of the capital endowments of the poor, poverty reduction is the long-term elimination of the dependency of the poor on social relations and vulnerability, with respect to changing environments (Rajasekhar, 2004). The fact that wage labour, in essence, is a pre-requisite to access microfinance implies that microfinance reinforces rather than challenges production relations: a key aspect of social relations.

Differences in households' initial endowments is a significant factor in what microfinance was used for, and the effect that microfinance had on poverty reduction. Households that had access to microfinance were, at times, able to widen their asset base and reduce their vulnerability to income shocks such as a health crisis[28]. By reducing vulnerability and smoothening household income, access to microfinance may have prevented households from sliding further into poverty. Members who were able to build their assets were also creating endowments for their children, contributing to long term poverty reduction. However, the benefits of microfinance were limited to member households, with little spill over effects for other members of the village.

While microfinance does transcend traditional caste barriers to the access to finance, providing some 'lower' caste households with access to financial capital, the

[28] The productive use of microfinance loans was dependent to a large extent on other government support, such as milk marketing cooperatives and housing grants, without which the microfinance loans would have been insufficient.

translation from financial access to poverty reduction is neither direct nor immediate. Microfinance does reduce the vulnerability to financial shocks for households that have access to it. While this may prevent the deepening of poverty for the household, in itself it doesn't reduce existing poverty. Households that are able to build productive assets also contribute to increasing the endowments and capabilities of future generations, beginning the long term process of poverty reduction for these households. However, while microfinance may help build people's endowments and capabilities to a certain extent, it does not change social or production relations in rural settings: an integral feature of rural poverty. Whether or not a development initiative such as microfinance reduces poverty, therefore, is a question that cannot be considered without a political economy analysis of the context in which is it being implemented.

Appendix 1

Table 10: India: Human Development Indicators

Human Development Index Rank (2008)	128
GDP per capita (PPP US$, 2005)	$3,452
Population undernourished	20%
(% of total population, 2004)	
Share of income or expenditure	
Richest 20% of population	45.3%
Poorest 20% of population	8.1%
Population living below the national poverty	27.5%
line (2004-05)	
Urban	25.7%
Rural	28.3%

Source: UNDP Human Development Report 2008; Reserve Bank of India website

Table 11: Profile of rural India

Households with 1 hectare or less	66%
Farmer households in debt	48.6 %
Households without access to formal credit	73%
Percentage living below the poverty line	28%

Source: Speech, PC Chidambaram, Finance Minister, GoI (2006), Speech, Thorat (UK) and the Reserve Bank of India

Table 12 Self-Help Group Bank Linkage Programme 1992-2008

SHG- BANK LINKAGE PROGRAMME - CUMULATIVE PROGRESS			
Year (End-March)	No. of SHGs Linked	Bank Loan	Refinance Assistance
			(Amount in Rupees crore)
1992-93	255	0.29	0.27
1993-94	620	0.65	0.46
1994-95	2122	2.44	2.13
1995-96	4757	6.06	5.66
1996-97	8598	11.84	10.65
1997-98	14317	23.76	21.39
1998-99	32995	57.07	52.06
1999-00	114775	192.98	150.13
2000-01	263825	480.87	394.98
2001-02	461478	1026.34	790.24
2002-03	717360	2048.67	1412.71
2003-04	1079091	3904.2	2118.15
2004-05	1618456	6898.46	3085.91
2005-06	2238565	13975.43	4153.63
2006-07	2924973	18040.74	5446.49
2007-08 P	3477965	22268.32	7061.99

P: Provisional

Source: NABARD and Reserve Bank of India (RBI) website: http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Handbook%20of%20Statistics%20on%20Indian%20Economy and http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/87453.pdf

Appendix 2: Interview Questions

Explain the purpose of the study and ask the participant whether they would like to participate, indicating that they can withdraw from the study at any time, in accordance with the Saint Mary's University Research Ethics Board guidelines.

Thank the participant for their time and build rapport by asking them general questions, most often about their children such as how many children they have, of what ages and what the children do.

Information on household and occupation

- How many people live in your household? Could you tell me about the caste of your household?
- Could you describe some of the main activities that you engage in on a daily basis? Is this the similar around the year?
- What are the main activities that people in your household are engaged in? Is this the similar around the year?
- Could you describe the nature of the work? (Probes: Employed/ Self-employed/ Who does what: men and women/ Employment relations/ Choice of work/ Options for work available in the village/ What their work entails)
- Does your family own land? If so, what size and what is it used for? Does your family work on it or do you hire others to work on it (or both or neither)?

- For those engaged in own-farm work:

- Does your family work on the same land all year round?
- What types of crops do you grow? Do you usually rent equipment (tractors/ bullock carts etc) to help plough and harvest the land?
- What influences the decision of what crops are grown?
- How long have you/ your family been involved in agricultural work and has that changed?
- Are you or other members of your household engaged in other farm or non-farm activities?
- Do you own livestock? If yes, what and how much?
- Could you describe what you do with the farm output? (Probes: sell in the market or consume within the household or barter within the community or other)
- Do the sales from the harvest cover expenses for the rest of the year?
- If not, what are the other sources from which you gain an income?

Some relative indicators of poverty

- Can you describe the major expenses of your household? Does your household get enough to eat all year round? Is your household able to cover all its expenses all year round? If not, what do you do?

- What do you do when a member of your household is sick? (Probes: access to health care / expenses/ impact on household expenses).
- What ration card does your family use (identifies whether above or below the national poverty line)?

Observation: house and assets

Access to finance

For Self-Help Group member households

Microfinance

- How long have you been part of the Self-Help Group? Could you describe your experience / impressions?
- Why did you decide to join? There are others in the village that have not joined the group: would you know why?
- Have you used the savings facilities? Do you find them beneficial?
- Have you taken a loan from the SHG?
    - If no, why not?
    - If yes, is this your first loan?
        - What did you use the loan(s) for?
        - Do you feel that it has benefited you and your family?
        - Have you repaid the loan / do you think you can repay the loan?

- Do you think that you would take another loan from the SHG? Why/why not/ for what purpose?

Access to other forms of finance

- Are any members of your household currently in debt? Could you talk about the nature of your debt (Prompts: who indebted too, what the debt was for, duration of the debt, nature and condition of debt)?
- Have you or your family taken other loans in the past or thinking of taking loans in the future from other sources?
    - Why/ why not/ for what purpose? (Probe: terms and conditions on other loans, use of loan, nature of loan)
    - Where might you go for such a loan?
- How does it compare with taking a loan from the SHG?
- Do you think that the village has benefited by having the SHG in the village?
    - Why/ why not?

For non-Self-Help Group member households

Access to other forms of finance

- Are you currently in debt? Could you talk about the nature of your debt (Prompts: nature and duration of the debt)?
    - Who did you take the loan from and on what conditions?
    - What the loan taken for?

    - Do you think you may be able to repay the loan based on the conditions?

- Have you or your family taken a loan before? If so, would you be able to talk about the nature of those debts?
- Would you take a loan in the future? If yes, from where?

<u>Microfinance</u>

- Could you talk about why you are not involved with the Self-Help Group in your village?
- Do you think that not being involved has had an impact on your life? If so, in what way?
- There are others in the village that have not joined the group: would you know why?

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