The Evolution and Persistence of Informal Credit in Rural North India, (c. 1850-2010)

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Abstract: This paper presents a historical analysis of the rural credit ecosystem in colonial and post-colonial North India, with a specific focus on the Punjab-Haryana region. It argues that the institution of the moneylender, far from being a static feature of a traditional economy, was dynamically shaped by state policy, legal frameworks, and infrastructural changes. The colonial period (c. 1850-1947) did not merely witness the persistence of the sahukar but actively constructed his power through the individualization of property rights, codified contract law, and cash revenue demands, creating a hybrid trader-lender embedded in the agrarian economy. Post-Independence, the Indian state embarked on an ambitious project to architect a formal rural credit system, aiming to displace private moneylenders through cooperatives and social banking. This paper analyzes the qualified success of this project, demonstrating how the heyday of directed credit in the 1970s-80s was followed by a retreat during the liberalization era of the 1990s. The paper concludes that the rural credit landscape in India is best understood as a layered system, where formal and informal sectors coexist and interact, with the historical legacy of the colonial-era sahukar continuing to influence the structure and function of rural finance into the 21st century.

Keywords: All-India Rural Credit Survey, Colonial Policy, Informal Finance, Liberalization, Moneylender, Reserve Bank of India (RBI), Rural Credit, Social Banking

INTRODUCTION

The provision of credit is the lifeblood of any agrarian economy, determining production cycles, shaping social relations, and influencing patterns of accumulation and dispossession. In the historiography of rural India, the figure of the moneylender, or *sahukar*, looms large, often depicted as a perennial and exploitative force. This paper challenges ahistorical conceptions by arguing that the nature, scope, and power of rural credit mechanisms have been profoundly transformed by successive political regimes. From the colonial state to the post-colonial developmental state and into the era of economic liberalization, policy interventions have continuously reshaped the credit landscape, creating, bounding, and reconstituting the space for both formal and informal finance.

The core thesis of this paper is threefold. First, during the colonial period, the British Raj, through a triad of legal, fiscal, and infrastructural interventions, systematically forged the modern incarnation of the moneylender as a powerful, hybrid trader-lender. Second, the post-colonial Indian state, while explicitly aiming to dismantle the sahukar's dominance, ultimately created a system where formal and informal credit coexisted in a complex, often symbiotic, relationship. The formal system expanded dramatically but was plagued by internal contradictions, leaving specific credit niches open. Third, the economic reforms of the 1990s redefined this relationship once more, scaling back the state's credit provisioning and creating conditions for a resilient resurgence and reconfiguration of informal finance, albeit in new, adapted forms.

This study employs a historical-institutional approach, tracing the evolution of rural credit policies and their on-ground outcomes over a long duration. It draws upon a rich archive of colonial settlement reports, gazetteers, committee reports, post-Independence Reserve Bank of India (RBI) publications, National Sample Survey (NSS) data, and policy documents. Geographically, it concentrates on the Punjabi-Haryanavi countryside, with illustrative examples from districts like Sonipat, to provide a coherent regional narrative that reflects broader all-India patterns.

The paper is structured in four parts. Part I examines the colonial construction of the moneylender. Part II analyzes the diagnostic phase and institutional response of the early post-Independence state, culminating in the All-India Rural Credit Survey and the creation of the State Bank of India and NABARD. Part III covers the period of "social banking" and its subsequent unravelling during the liberalization era of the 1980s and 1990s. Finally, Part IV explores the post-liberalization landscape, where a layered credit system emerged, characterized by the persistent and adaptive presence of informal finance alongside a more targeted, but often exclusionary, formal sector.

Part I: The Colonial Construction of the Hybrid Creditor (c. 1850-1947)

In late pre-colonial and colonial North India, the term "moneylender" concealed a varied spectrum, from itinerant lenders to stationary shopkeepers, grain-dealers, and organized urban indigenous bankers. However, in the agrarian regions of Punjab, including present-day Sonipat, Vaishya and Baniya subcastes were disproportionately represented in these roles. The colonial state's project of agrarian transformation fundamentally altered this spectrum, consolidating the power of a specific type of creditor: the merchant Baniya who acted as more than a mere creditor. He combined multiple functions grocer, commission agent, sales broker, accountant, and savings custodian mediating between peasant producers and distant markets through advances and consignment relationships. His power rested on a confluence of factors: liquidity, literacy in accounting, caste-trust networks, and critically, access to newly formalized legal instruments of debt enforcement.

A sequence of colonial changes in the later nineteenth century created the conditions for this hybrid role. The annexation of Punjab (1849), followed by cadastral surveys and the individualization of proprietary rights, created alienable land titles. The fixation of land revenue demands in cash, coupled with the broad monetization of the economy, generated seasonal cash needs for the peasantry. Simultaneously, the extension of colonial courts and codified civil procedures for debt and contract formalized debt enforcement and the collateralization of land. These legal changes were revolutionary; they enabled the conversion of crops and land into collateral, giving moneylenders systematic leverage over peasant assets via liens, usufructuary mortgages, and conditional sales. In effect, the state's legal-institutional apparatus made the moneylender's claim enforceable, scalable, and transportable, differentiating him from customary lenders who relied on informal social sanctions.

Infrastructure development, particularly the proliferation of railways and canals, further cemented this role. Railways lowered transport costs and expanded market reach, increasing the incentives for intertemporal and spatial arbitrage in grain markets. The sahukar, already positioned as a grain dealer, was the natural actor to extend credit against the future crop, merging trade and lending into a single, highly profitable business model. The railway penetration into the Delhi-Punjab trunk line, for instance, integrated Sonipat's *mandis* into regional circuits, elevating the value of the sahukar as the peasant's crucial access point to distant demand.

By the last quarter of the nineteenth century, the intensity of agrarian indebtedness rose markedly. Officials recorded that land sales and mortgages by cultivators were increasingly

transferring proprietary rights to moneylenders. This generated a political concern for the colonial state: the erosion of the peasant proprietory class, a key pillar of the Raj's stability and its claims of agrarian prosperity. The state's response was not to remove the Baniya's ability to supply credit, which was essential for revenue collection, but to clip his ability to convert debt into land. This led to the landmark Punjab Alienation of Land Act (PALA) of 1900.

The PALA created a legal dichotomy between "agricultural" and "non-agricultural" tribes, prohibiting the permanent alienation of land from the former to the latter. This legislation was a profound moment of colonial statecraft. It explicitly recognized the Baniya as the paradigmatic creditor while simultaneously protecting agricultural proprietors from dispossession. Its effect was to redirect the Baniya's portfolio away from long-term, land-collateralized credit and towards short-term loans secured by movable collateral such as jewellery, grain, or through proxy arrangements with agriculturist intermediaries. The PALA, therefore, preserved the Baniya's primacy in the credit supply chain but constrained his most explosive avenue for accumulation, demonstrating the state's role in actively managing, rather than dismantling, the informal credit system.

Part II: The Post-Colonial Diagnostic and Institutional Response (1947-1970)

The first decade after Independence framed India's rural finance problem as both a developmental imperative and a political-economy legacy. On the eve of planning, formal finance had a vanishingly small footprint outside towns; rural credit was dominated by sahukars. Early Reserve Bank of India (RBI) inquiries, culminating in the seminal All-India Rural Credit Survey (AIRCS), concluded that light-touch administrative reform would not suffice, and that positive and deliberate state action was required to re-architect rural credit. The benchmark established by the AIRCS (1951-52) was unequivocal: formal institutions were utterly insignificant in providing rural credit. The Survey found that institutional sources accounted for well under a tenth of rural household debt, with the share of commercial banks around a single percentage point. Roughly more than 90% of rural households relied on informal finance, with moneylenders accounting for on the order of 70% of rural credit. The Committee of Direction diagnosed past state involvement in cooperatives as having over-administered and under-financed them.

In response, the AIRCS proposed a two-pillar architecture. First, it prescribed an integrated cooperative system under close RBI coordination, with the central bank's Agricultural Credit Department ensuring discipline, liquidity support, and credit planning. Second, to overcome the urban bias of private banks, it recommended creating the State Bank of India (SBI) by statutory amalgamation of the Imperial Bank of India, with a mandate for an "expeditious programme of banking expansion, particularly in the rural areas," and to support cooperatives operationally and financially. Parliament operationalized this vision via the State Bank of India Act (1955) and the SBI (Subsidiary Banks) Act (1959), creating a state-partnered commercial bank with a rural mandate.

This design recognized that cooperatives could anchor primary society-level intermediation, while a state-partnered commercial bank could provide correspondent services, liquidity, and branch-based retail services. The aim was not the immediate elimination of moneylenders, but the construction of a substitute system capable of contesting their dominance. In regions like Sonipat, which was already plugged into Delhi's market, the presence of SBI-linked services catalyzed merchant engagement with formal banking for deposits and trade finance. However, the fundamental advantages of moneylenders hyperlocal presence, low search and enforcement costs built on social ties posed a significant challenge to formal lenders, who faced inherent information and monitoring disadvantages in atomized rural markets.

Part III: Social Banking and Liberalization: Expansion and Retreat (1970-2000)

The 1970s and 1980s marked the high tide of social banking in India. The nationalization of major commercial banks in 1969 and 1980 was a watershed, explicitly directing bank resources towards priority sectors, including agriculture. Branch licensing and unbanked centre rules ensured that roughly four-fifths of new branches opened between the late 1970s and 1990 went to rural and semi-urban locations. This dramatically altered access; the share of rural credit in total bank credit rose from low single digits in the late 1960s to the mid-teens by the late 1980s. The creation of the National Bank for Agriculture and Rural Development (NABARD) in 1982 created a dedicated refinance hub, while the Regional Rural Bank (RRB) network scaled to cover most districts.

This expansion had tangible effects. It quantitatively displaced informal creditors from a large share of *production credit* among medium and many small cultivators. It also expanded deposit formalization, tightening the space for savings/credit interlocks that moneylenders had traditionally relied on. However, this expansion strained the financial viability of public rural intermediation. High transaction costs, politicized targeting, and weak recovery pushed many RRBs and cooperatives into chronic losses. Recovery rates for rural lending were often reported in the 50–60% range through the 1980s, a level unsustainable without repeated recapitalisation. The nationwide agricultural loan waiver in 1989, intended as one-off relief, had a profound collateral effect on credit culture, signalling that political interventions could wipe out obligations and depressing repayment incentives.

The 1990s, ushered in by the Narasimham Committee reports on financial sector reform, reoriented banking towards prudential norms, profitability, and market-determined allocation. Administered interest rates were dismantled, directed credit targets were diluted, and banks were permitted to rationalize their rural branch networks, closing or merging persistently loss-making branches. The intent was to restore bank health and reduce politicised credit, but the transitional effects on rural credit were predictable: a slower growth (or absolute contraction) of rural credit outstanding as a share of total bank credit, a decline in the incremental credit-deposit ratio at rural branches, and a relative withdrawal from small-ticket and geographically remote lending.

This policy pivot re-opened niches where informal creditors had comparative advantages. Banks, under tighter prudential standards, had weak incentives to transact small, urgent, unsecured loans with high verification costs. Moneylenders, shopkeepers, and commission agents, armed with relationship information, retained or regained these functions. In Sonipat, trader-creditors extended advances in kind (seed, fertiliser) or cash against future produce, enforcing repayment through deductions at procurement. For smaller cultivators with thin documentation or prior defaults, informal loans, while costlier, came with rapid disbursement and flexible collateral, making them a rational choice. The archetypal moneylender increasingly began to overlap with other roles input dealer, commission agent, processor just as he had a century prior.

Part IV: The Layered System: Coexistence and Reconfiguration (2000-2010)

The early 2000s did not see a simple return to the pre-banking era but the consolidation of a layered financial system. Formal institutions did not retreat entirely; rather, they became more selective. Initiatives like the Kisan Credit Card (KCC) standardized and subsidized crop loans, directly competing with and displacing moneylenders from production-credit niches. The SHG-Bank Linkage Programme and the subsequent rise of regulated Microfinance Institutions (MFIs) delivered repeat, cash-flow-based credit to low-income borrowers, often substituting high-cost informal loans, particularly for women.

Simultaneously, policy innovations like the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) incentivized banks to lend without hard collateral, bridging

a historic weakness of formal lending. The massive push for financial inclusion post-2005, culminating in the Pradhan Mantri Jan Dhan Yojana (2014), made bank accounts ubiquitous, widening the state's direct benefit transfer pipeline and further integrating rural households into the formal financial system.

Despite these advances, informal finance remained elastic and ubiquitous in smaller domains. Its persistence can be attributed to its embeddedness in local production and trade cycles. In Haryana's grain and oilseed markets, commission agents (*arhatiyas*) continued to bridge farmers and buyers, advancing cash or inputs and recovering through sale proceeds. Banks financed larger firms and warehousing, but the last-mile pre-harvest advance and intra-season liquidity smoothing were frequently underwritten by these trader-creditors, especially for smaller producers. The informal sector's ability to provide bespoke, relationship-based credit with minimal paperwork and immediate disbursal ensured its continued relevance. The formal and informal systems were no longer seen as simple substitutes but as complementary, if unequal, layers of a complex rural financial architecture.

CONCLUSION

The journey of rural credit in North India from the colonial sahukar to the modern State Bank is not a story of linear progress or simple displacement. It is a narrative of state-induced transformation, institutional adaptation, and persistent informality. The colonial state, through its legal and revenue policies, actively constructed the powerful, hybrid moneylender as a necessary intermediary in a monetizing agrarian economy. The post-colonial state diagnosed this dependency as a problem and launched an ambitious counter-project to build a formal, institutional credit system.

This project achieved significant successes, particularly in displacing moneylenders from the provision of agricultural production credit to medium and large farmers. However, the internal contradictions of social banking politicization, poor recoveries, and high costs led to its partial retreat during the liberalization era. This retreat, coupled with the inherent limitations of formal banking in serving the last mile, created space for the re-emergence and reconfiguration of informal finance. The contemporary landscape is thus a layered system: a formal sector that is more efficient and targeted but also more exclusionary, coexisting with a resilient informal sector that remains deeply embedded in the social and economic fabric of rural life, fulfilling needs that formal institutions are structurally ill-equipped to meet. The shadow of the colonial sahukar, therefore, continues to fall on the fields of Sonipat and beyond, a testament to the enduring complexity of rural finance in India.

FOOTNOTES

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