INFORMAL AND FORMAL CREDIT IN RURAL KENYA

A Case of Western Kenya Grassroots Borrowing and Lending in an Institutional Development Perspective

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INTRODUCTION

The channelling of increasingly large amounts of development credit into the rural sector can be traced to the 1970s. It was mainly the outcome of the identification of rural development as the focus of aid and development strategies under the aegis of the World Bank.[1] There is no doubt that for the developing countries in particular this was a major landmark in development thinking and practice marking a departure from macro oriented economic policy focused on growth and industrialisation strategy with a heavy urban bias. Instead, the traditional and underdeveloped sectors, especially agriculture, which were hitherto neglected somewhat suddenly became of prime concern.[2] A significant highlight of this new trend was the increased earmarking, promotion and distribution of credit for production within the agricultural sector.[3]

It should however be noted that the emergence of official credit specifically for smallholders was closely linked to the concern basically of modernisation of the agricultural sector. In most sub-Saharan African countries historically this happened a decade or two earlier towards the end of the colonisation period. In the case of Kenya it was in the 1950s when, with the view to impending political independence, the concern with agricultural modernisation embraced the African farmers. It was then that the colonial administration initiatives to provide agricultural credit for African smallholders farming started.

It was, at any rate, later in the 1970s, when credit became part of the rural development package, that organisational arrangements for distribution of official credit to smallholders in Kenya started emerging. These took the form of special credit schemes essentially for production of specific crops for instance coffee, cotton, sunflower, sugarcane, tea, maize etc.

It is the broad objective of this discussion to examine the different organisations for credit in the rural sector in Nyanza and Western provinces of Kenya focusing on the relations between informal and formal credit to determine the role of both in rural development. The two major issues to be addressed are first, the form of rural institutions for borrowing and lending in terms of their origins, methods and scope of operations, services, leadership and clientele/beneficiaries. Secondly, the role and capabilities of these institutions in rural smallholders socio-economic development.

Credit Organisation as Rural Institution-Building

The analysis of the various forms in which borrowing and lending takes place amongst smallholders can basically be understood in the broader context of building institutions for rural development. It is indeed now well recognised among students of rural development that institution-building is a major, if not a key, factor in realising the various objectives of development effort in the rural areas.[4]

The main rationale for institution-building derives from the focus, especially since the 1980s, on sustainability of initiatives in rural development. In a fundamental sense, in relation to institution-building, and particularly in terms of implementation of rural programmes, sustainability has meant the development of the capacity of the rural people to manage their own affairs. It is further argued that this capacity that enables rural residents to determine and control their own affairs can be realised through strong local institutions.[5]

Local level institutions for development would comprise government and non-government organisations, community organisations including indigenous based groups, co-operatives, etc. In terms of the essential roles of these organisations these would include acting as catalysts for local development initiatives and projects, disseminators of new ideas, and innovations and providers of critical information. In a nutshell the critical role to be played by the local level institutions is to act as intermediaries between the people and government. They should provide avenues for participation to ensure development by people and for people such that economic growth translates into sustainable improved well-being of the people.[6]

The significance of the foregoing conceptualisation of local institutions and their role becomes apparent given the recent negative experience with Integrated Rural Development (IRD), which was a major perception of development in the rural areas very much in vogue in the 1970s. An important assumption of IRD was that a critical minimum effort essentially through external intervention was necessary to have a noticeable impact on target populations in a short time. The projects were therefore concentrated in a limited area and were administered through semi autonomous agencies which paralleled other government agencies. The focus of these projects conceived under IRD was on small farmers and an attempt to promote improvements in the quality of rural life and increase off-farm opportunities.[7]

Review analyses of IRD experience have revealed certain basic shortcomings running contrary to sustainable development emanating from people's participation and therefore of relevance here. First, the projects were based on inadequate knowledge of technical possibilities and small farm conditions.[8] They in particular exhibited little understanding of the local institutional environment by, for instance, ignoring local knowledge and indigenous organisations. The second shortcoming, related to the foregoing one, was that the administrators of these projects tended to regard rural communities as undifferentiated masses and therefore frequently ignored social structures and economic and political hierarchies. A major consequence was the local elite becoming the main participants and thereby reaping disproportionately larger benefits and not the targeted poorest 40 percent.[9] Thirdly the increased scope of rural development activities meant that most could not possibly be sustained simply because they exceeded the design, implementation and evaluation capacities of national governments and donor agencies.[10]

These shortcomings of IRD experience underline the need to approach the organisation of smallholders credit as rural institution-building. This in essence means that credit organisations should be seen to undergo an institutionalisation process that takes place over time, reflecting the particular organisation's own distinctive history - the people who have been in it, the groups it embodies and vested interests they have created, and the way the organisation has adapted to its environment.[11] The resulting institutions whether conceived as groups or practices are not just technical instruments like organisations designed as a means to definite goals that become expendable after the achievement of those specific goals such as organisations for the sole purpose of distribution of food to victims of a temporary famine. The institutions in question in addition, also have a "natural" dimension, being products of interaction and adaptation and having become receptacles of group idealism making them less readily expandable.[12] Thus non-indigenous and/or indigenous based institutions may be suitable for organising smallholders credit depending on the particular circumstances.

In the African context, however, the role of indigenous elements as regards rural smallholders credit is yet to be fully recognised. This is partly due to a persistent negative view of credit organised on the basis of indigenous arrangements. These have been generally regarded as working at best inefficiently and frequently censured for exploiting small scale borrowers. At the same time smallholders have been seen to be in desperate need of a prerequisite for adoption of new and profitable technologies. The major consequence has been emphasis on access to formal credit on concessionary terms and informal credit not assigned a proper role or being shunned altogether.[13]

Informal and Formal Credit

The analysis of the relations between informal and formal credit calls for a broad view of credit to include any transfer of goods or services between one person or group and another, or to any of its members, with expectation of a return at a later time. The return may take the same form or a different one.

The use of the term "informal" here is in the conventional sense, meaning non-institutional, unregulated. This is however not to suggest that unofficial systems are without unregulated activities. The formal-informal distinction usage is therefore not as a rigid analytical category but as a heuristic or shorthand device.

Moreover "informal" and "formal" modes of credit are not distinct spheres, but interlocking parts of larger, more complex networks of borrowing and lending. The parts may compete, co-operate symbiotically, or simply co-exist. They usually change in relative importance, seasonally and over longer periods.

The overflow of formal upon informal credit systems can take many forms. A good case in point is institutional lenders, through special credit schemes, deliberately seeking to 'undercut' informal lenders thought to charge exorbitant interest rates. And yet some institutional lending relies heavily on ancillary local-level "informal" lending for its functioning and vice versa. For instance long delays of co-operative loans often results in farmers arranging secondary loans among themselves to be able to complete the necessary farming activities especially land preparation, planting and weeding in time for the rains. Sometimes the promise of a formal loan can be used as a form of guarantee to secure informal credit.[14] Likewise, those receiving formal loans can lend to informal borrowers using these very same resources from formal sources.