Protecting Borrowers in Informal Lending

Why in news?

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Alleged harsh treatments by moneylenders have recently led to a number of suicides in Tamil Nadu.

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What is the real problem?

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- **Formal lending** - Even in the formal financial system, lenders can offer loans at relatively higher interest rates.
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- In the case of default, however, the lenders know that they cannot torture borrowers to get back their money.
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- So, they are generally wary of making high-risk loans unless they have access to collateral or are ready to negotiate a proper settlement in the case of default.
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- **Informal lending** - Given the above regulations informal borrowing naturally becomes the option.
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- Notably, the lending standards in the informal sector are generally looser.
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- As, the lenders have little reason to worry about the creditworthiness of the borrower.
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- This is because of the possibility of the chance to resort to violence to extort money in case of a default.
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- **Political affluence** - When aggressive and politically powerful lenders deal with weak borrowers, the inability to repay leads to violence.
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- In many cases, even the local law enforcement authorities function hand in glove with these lenders.

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- This ultimately leaves the borrowers in extreme distress with no legal recourse.
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How can this be addressed?

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- Both the above cases have been linked to harassment by financiers.
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- It thus has to be understood that high-interest lending per se is not the problem but the harsh dealing resorted by some informal lenders is.
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- Any attempt to outlaw all high-interest or usurious lending would impact the borrowers who genuinely benefit from informal lending.
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- Overall lending rates can be lowered, particularly in rural India, by allowing the free flow of capital in search of investment opportunities in the untapped markets.
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- E.g. Deregulation of microfinance by RBI led several microfinance institutions to enter the rural market attracted by the high return on capital offered by the sector and eventually helped lower borrowing rates.
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- Despite the source being a financial one, the recent incidence of deaths is more a law and order problem.
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- It is for the governments to bring in mechanisms to protect the borrowers.
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Source: The Hindu

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