THE LAW RELATING TO RURAL INDEBTEDNESS AND AGRICULTURAL CREDIT IN INDIA

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I. PRELIMINARY

1.1 This is a short note on the laws governing rural indebtedness and agricultural credit in India. This issue is of imperative concern in the light of an increasing number of farmers committing suicide to escape mounting debts.

II. BACKGROUND

(a) The Origins of the Legal Regime of Agricultural Credit

2.1 The first modern legal system governing agricultural credit in India began in colonial times. The colony being a creation of largely economic interests, agricultural policy in colonial India followed the 'revenue model', which saw in agriculture and land tenure an opportunity to augment the colonial state's exchequer. This is in opposition to the contemporary 'planned production model', which has attended to national objectives such as agrarian growth, domestic food security and profitable exports.

2.2 To consolidate their administrative and economic control, the government of colonial India organised a feudal arrangement of land tenure in which local elites were allowed to own vast tracts of land cultivated by serfs with a charge on most of the proceeds of such cultivation. In return, the landowners acted as conduits for tax collection. This was the zamindari model of land tenure; it was an extremely effective method of taxing land and agricultural produce, which, in a vast country with an economy dominated by agriculture, was a lucrative revenue source.

2.3 With farmers having to pay most of their incomes to meet the government's revenue requirements, agricultural growth, land improvement and food security suffered tremendously. The situation soon deteriorated into famine. Following the disastrous famines at the end of the nineteenth century and the consequent reports of the famine commissions appointed to look into their causes, the colonial government enacted two laws that formed the basis of agricultural credit in the country: the Land Improvements Loans Act, 1883, and the Agriculturists Loans Act, 1884.

(b) <u>*Past Legislation Governing Agricultural Credit*</u>

(i) The Land Improvement Loans Act, 1883

2.4 After the devastation of successive famines on the Indian economy and the reports of the famine commissions which suggested a complete breakdown of agricultural credit systems in the country, the colonial government, following the opinions of the governments of India's provinces that highlighted the need for urgent simplification of credit procedures, enacted the Act of 1883. The Act of 1883 provided for a system of credit advancement by authorised "companies" in compliance with government guidelines. All loans were made repayable in instalments, in the form of an annuity or otherwise, within a notifiable period ordinarily within thirty five years. Village communities could also borrow for which they were jointly and severally liable with their individual liabilities certified by the loan disbursing officer. The enactment gave wide rule-making powers and discretion to local governments.

(ii) The Agriculturists' Loans Act, 1884

2.5 The Act of 1884 repealed existing 'takkavi' laws in the country that only provided for the recovery of a loan's principal amount and not the interest on the loan or the cost incurred by the government in advancing the loan. The existing law also did not provide for loans to members of a village community. The new Act allowed the local governments to make rules for credit advancement to landowners for any purpose not covered by the Land Improvement Loans Act but nonetheless connected with agriculture. All loans were made recoverable, with all interest chargeable and costs incurred, from the borrower, as arrears of land revenue; and, the borrower's surety, as arrears of land revenue.

(iii) The Cooperative Societies Acts

2.6 To establish and incorporate credit societies outside the procedures of the Companies Act, the colonial government, in 1904, enacted the first Cooperative Societies Act which applied to only those societies dedicated to cooperative credit. Societies were divided into rural and urban categories with the former vested with unlimited liability. This Act of 1904 was replaced by the Cooperative Societies Act, 1912, which governed all cooperative societies irrespective of their purpose, distinguished between them on the basis of their liability, required all agricultural societies to have unlimited liability and restricted the profits of their members.

(iv) The Usurious Loans Act, 1918

2.7 The prevalence of social concerns over market-determined interest rates can be seen in the enactment of the Usurious Loans Act, 1918, which gives courts *suo moto* powers to initiate proceedings to deal with usury. Section 3 of the Act authorises courts to reopen loan transactions and relieve the debtor's of any liability arising out of excessive interest if the court is satisfied that:

- The interest levied is excessive; or,
- The transaction was substantially unfair.

Courts are also given power to deem an interest rate excessive. Interest alone is of sufficient evidence to prove substantial unfairness of the transaction.

(v) Provincial Laws in the 1930s

2.8 Closely linked as it was to rural welfare – a central theme in the Indian national movement prior to Independence – it is not surprising that the next large steps taken to protect the interests of Indian agriculture came from the newly elected provincial assemblies elected after the passage of the Government of India Act, 1935. Important steps were taken by several States to protect farmers from excessive interest rates on loans, both from banks and moneylenders –

(a) In 1936, the Madras Legislature amended the Usurious Loans Act to introduce two significant provisions:

- A rebuttable presumption of the substantial unfairness of a transaction if the interest is excessive; and,
- An irrebuttable presumption of excessive interest if compound interest is charged on an agricultural loan.

(b) In addition, several provinces enacted laws to curb rural indebtedness. Many of these laws still exist today albeit after considerable changes. The Madras Debtors Protection Act, 1934, was amended by the Legislature in 1936 to provide for a presumption of usury and substantial unfairness where the interest rate was excessive. Compound interest on agricultural loans was declared usurious and prohibited. The Andhra Pradesh (Andhra Area) Debtor's Protection Act, 1934, was amended on identical lines. The practice of *dam dupat* was prohibited by the Punjab Relief of Indebtedness Act, 1934, which disallowed courts to decree a debt for a sum double the principal amount; and, made such debts voidable at the instance of the debtor.

2.9 However, most pre-Independence provincial legislations, even those curbing money lending, stopped short of an outright ban on compound interest and usury, banks and cooperatives being always excluded or exempted. Bihar was the first state to break from this mould when in 1939 its Legislature passed the Bihar Money Lenders Act, 1939. For the first time banks and cooperatives were brought within the definitions of both 'loan' and 'money lender' thereby disallowing their charging of compound interest on, and prohibiting the attachment of the property of, agricultural debtors.

2.10 There is, therefore, a historical and accepted difference between agricultural credit and commercial credit. There is also incontrovertible evidence that the increasing incidence of suicide among Indian farmers is directly linked to agricultural debt and the inability of farmers to repay their loans.

2.11 Broadly, agricultural credit in India is advanced by,

(a) money-lenders, and
(b) banks.

III. THE LAW REGARDING THE REGULATION OF MONEY-LENDING

3.1 The legislative competence of the Union and the States is divided subject-wise between them in three Lists contained in the Seventh Schedule of the Constitution. The Constitution lays down that the power of the Union and the States shall be exclusive in the areas of their respective Lists (List I or 'Union List' and List II or 'State List'); and, that the Union's power will prevail in respect of any matters in List III ('Concurrent List'). Entry 30, List II reads thus,

> "*30. Money-lending and money-lenders; relief of agricultural indebtedness.*"

Hence, by virtue of Entry 30 of List II, money-lending is within the exclusive legislative competence of the States.

3.2 Pernicious practices, such as money-lending, are not constitutionally protected as a trade under the Constitution. This was laid down by the Supreme Court in *Fatehchand Himmatlal* (1977) 2 SCC 670 where, while dealing with a constitutional challenge to the Maharashtra Debt Relief Act, 1976, the Court ruled at pr. 38, *"A meaningful, yet minimal, analysis of the Debt Act, read in the light of the times and circumstances which compelled its enactment will bring out the humane setting of the statute. The bulk of the beneficiaries are rural indigents and the rest urban workers. These are the weaker sections for whom constitutional concern is shown because institutional credit instrumentalities have ignored them. Money lending may be ancillary to commercial activity and benignant in its effect, but money lending may also be ghastly when it facilitates no flow of trade, no movement of commerce, no promotion of intercourse, no servicing of business, but merely stagnates rural economy, strangulates the borrowing community and turns malignant in its repercussions. <u>The former may surely be trade but the latter – the law may well say – is not trade. In this view, we are more inclined to the view that this narrow, deleterious pattern of money lending cannot be classed as 'trade'</u>. No other question then arises, since the petitioners and appellants cannot summon Article 301 to their service."* (Emphasis supplied)

[See also, *R. M. D. Chamarbaugwala* AIR 1957 SC 699, *Khoday Distilleries* (1995) 1 SCC 574, *McDowell & Co.* (1996) 3 SCC 709 and *Devans Breweries* (2004) 11 SCC 26]

3.3 Hence, it is open for States to enact legislation to regulate money-lending [See, *Fatehchand Himmatlal* (1977) 2 SCC 670, *Pathumma* (1978) 2 SCC 1 and *S. Ganpathraj Surana* 1993 Supp (2) SCC 565].

3.4 However, even if money-lending were to be given the shade of constitutional protection of a trade, it may still be subject to restrictions. This is because legislation in the public interest that is consistent with the equality dispensation of the Constitution may impose reasonable restrictions on the freedom of a particular trade under Article 19(1)(g) [See, Article 19(6) of the Constitution. See also, *Bijay Cotton Mills* AIR 1955 SC 33, *Raghubir Dayal* AIR 1962 SC 263, *Sreenivasa General Traders* (1983) 4 SCC 353, *MRF Ltd.* (1998) 8 SCC 227 and *New Bihar Biri Leaves* (1981) 1 SCC 537].

IV. <u>THE LAW REGARDING THE REGULATION OF BANKING TRANSACTIONS</u>

4.1 Banking is subject to the exclusive legislative competence of the Union. Entry 45, List I reads thus,

"45. Banking"

4.2 Courts used to have the power to reopen banking transactions on grounds of excessive interest or substantial unfairness between the parties. This power was traceable to Section 3(1) of the Usurious Loans Act, 1918, which read as follows,

> "***3. Re-opening of transaction. –***
>
> *(1) Notwithstanding anything in the Usury Laws Repeal Act, 1855 (28 of 1855), where, in any suit to which this Act applies, whether heard ex parte or otherwise, the Court has reason to believe,*
>
> *(a) that the interest is excessive; and*
>
> *(b) that the transaction was, as between the parties thereto substantially unfair,*
>
> *the Court may exercise all or any of the following powers, namely may,-*
>
> *(i) re-open the transaction, take an account between the parties and relieve the debtor of all liability in respect of any excessive interest;*
>
> *(ii) notwithstanding any agreement, purporting to close previous dealings and to create a new obligation, re-open any account already taken between them and relieve the debtor of all liability in respect of any – excessive interest, and if anything has been paid or allowed in account in respect of such liability, order the creditor to repay any sum which it considers to be repayable in respect thereof;*
>
> *(iii) set aside either wholly or in part or revise or alter any security given or agreement made in respect of any loan, and if the creditor has parted with the security, order him to indemnify the debtor in such manner and to such extent as it may deem just:*
>
> ***Provided*** *that, in the exercise of these powers, the Court shall not*
>
> *(i) re-open any agreement purporting to close previous dealings and to create a new obligation which has been entered into by the parties or any persons from whom they claim at a date more than twelve years from the date of the transaction;*
>
> *(ii) do anything which affects any decree of a Court.*
>
> ***Explanation:*** *In the case of a suit brought on a series of transactions the expression "the transaction" means, for the purposes of proviso (i), the first of such transactions.*

4.3 There are a number of cases where the Usurious Loans Act has been used by courts to examine loans that were unfair or excessive and relieve the debtor of liability [See, *Dayawati* AIR 1966 SC 1423, *Srinivasa Vardachariar* AIR 1967 SC 412 and *C. T. George* AIR 1975 Ker 169].

4.4 However, in 1984, Parliament enacted an amendment to the Banking Regulation Act, 1949, to insert a new Section 21A to bar the jurisdiction of courts to examine banking debt transactions on the grounds of excessive interest. Section 21A reads as follows,

> ***"21-A. Rates of interest charged by banking companies not to be subject to scrutiny by courts. –*** *Notwithstanding anything contained in the Usurious Loans Act, 1918 (10 of 1918), or any other law relating to indebtedness in force in any State, a transaction between a banking company and its debtor shall not be reopened by any Court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive."*

4.5 Section 21A of the Banking Regulation Act overrides Section 3 of the Usurious Loans and, therefore, courts can no longer reopen usurious loan transactions [See, Section 3 of the Usurious Loans Act; and, *Yasangi Venkateshwara Rao* (1999) 2 SCC 375, *N. M. Veerappa* (1998) 2 SCC 317, *Koramsetty Venkateswarlu* AIR 1986 AP 290 and *Advath Sakru* AIR 1994 AP 170].

V. LEGISLATIVE COMPETENCE OVER DEBT RELIEF

5.1 As discussed above, there is no doubt that the States are competent to legislate to regulate money lending.

However, the primary question is whether the States are competent enact legislation that will affect banking [Entry 45, List I] even though the States are competent to legislate on "*...relief of agricultural indebtedness.*" [Entry 30, List II].

5.2 For a State to claim competency, it must show that the "pith and substance" of the proposed legislation falls in the State's List (List II, Schedule VII) or the Concurrent List (List III, Schedule VII) but does not fall within the Union's List (List I, Schedule VII). Where a subject matter does not appear to fall in the State or the Concurrent List, it falls within the 'residuary' power of the Union [See, Entry 97, List I read with Article 248 of the Constitution in the light of *H. S. Dhillon* (1971) 2 SCC 779].

5.3 Apart from applying the doctrine of pith and substance, the Constitution lays down that the power of the Union and the States shall be exclusive in the areas of their respective lists; and, that the Union's power will prevail in respect of any matters in the Concurrent List [See, Articles 245 and 246 of the Constitution]. But, this principle of exclusivity is subject to the detriment of the States by certain Entries in List II that specifically safeguard the Union's power even on matters which are otherwise exclusively within the State's competence [Sees, Entries 1 (public order), 2 (police), 13 (communications), 17 (water), 22 (courts of wards), 23 (mines and minerals), 24 (industries), 26 (trade and commerce), 27 (production, distribution and supply of goods), 32 (incorporation), 33 (cinema), 51, 55, 57 and 63 (concerning certain excise, taxes, fees and stamp duties)].

5.4 The broad principles for determining legislative competency are: (a) the principle of pith and substance to determine which Entry or Entries a legislation falls under, (b) the principles of exclusivity so that the Union and States do not encroach on each others powers [Articles 245 and 246], (c) the principle of repugnancy denying States the power to infringe Union legislation in the Concurrent List [Article 254], and (d) invoking special principles for a situation of emergency or to fulfil international obligations [Articles 249 and 253].

5.5 In interpreting the scope of any Entry, (a) a broad substantive interpretation must be given to each entry treating it as a field of legislation to give the words the widest possible meaning so that they may have effect in their widest amplitude [See, *Atiqa Begum* AIR 1941 FC 16 and *Calcutta Gas Co.* AIR 1962 SC 1044], (b) any interpretation must ensure that "each general word should be held to extend to all ancillary and subsidiary matters which can be said to be fairly and reasonably comprehended in them" [See, *Edel Hotels and Investment Ltd.* AIR 1990 SC 1664] and, (c) while bearing in mind both the principles of exclusivity and repugnancy, a harmonious interpretation must be given in inter-relating entries [See, *Harkachand* AIR 1970 SC 1453; and, for examples, *Balsara* AIR 1951 SC 318 and *Tika Ramji* AIR 1956 SC 676].

5.6 Therefore, it is not open for the States to enact legislation, the pith and substance of which affects banking [See, *Associated Timber Industries* (2000) 7 SCC 93, *Bank of Baroda* (1989) 4 SCC 470 and *N. M. Veerappa* (1998) 2 SCC 317].

5.7 However, States may competently legislate on rural indebtedness to the exception of banks to provide debtors suitable relief.

VI. POWERS OF THE RESERVE BANK TO REGULATE AGRICULTURAL LOANS

6.1 In the absence relevant Union legislation and the inability of States to regulate loans advanced by banks, recourse may be had to the regulatory powers of the Reserve Bank of India (RBI). The RBI is vested with the power to regulate all banking in the country.

6.2 In exercising its regulatory powers, the RBI may issue circulars or directions to banks which the latter are bound to comply with [See, Sections 21(3) and 35A(1) of the Banking Regulation Act; and, *Canara Bank* (1998) 6 SCC 526 and *Central Bank of India* (2002) 1 SCC 367].

6.3 The circulars of the RBI under sections 21 and 35A of the Banking Regulation Act are of statutory effect [See, *Canara Bank* (1998) 6 SCC 526 and *Central Bank of India* (2002) 1 SCC 367].

6.4 In the exercise of its regulatory powers, the RBI can specify maximum limits for interest rates and other aspects of agricultural loans [See, *D. S. Gowda* (1994) 5 SCC 213, *H. P. Krishna Reddy*, AIR 1985 Kant 228 and *Karnam Ranga Rao* AIR 1986 Kant 242].

VII. CONCLUSIONS

7.1 Therefore,

(a) There is incontrovertible evidence that rising agricultural debts are forcing farmers to commit suicide and severely affecting Indian agriculture;

(b) In order to fulfil the objects of the scheme of constitutional protection, the States' power to legislate in relief of rural indebtedness must also extend to bank debts;

(c) The continued existence of Section 21-A of the Banking Regulation Act prevents courts from examining banking transactions for usury, even where the debtor is an impoverished farmer;

(d) While the States' are unable to legislate to protect farmers, the Reserve Bank of India must exercise its supervisory power to place limits on the rates of interest that may be charged on agricultural loans;

(e) The crisis in Indian agriculture is manifold; its legal resolution requires legal reform. Relief schemes and government charity will not suffice.
