CHAPTER TWO

# 2. Resource Acquisition and Use of Credit in Agriculture

## 2.1. Resource Acquisition in Agriculture

The capital requirements of a farm or ranch business are large and increasing due to inflation, technological change, and increase in farm size. With the need to control land, machinery, livestock, and other resources worth hundreds of thousands of dollars, many prospective young farmers as well as policymakers are asking with increasing concern, "How can the capital needed for a viable farming operation be acquired?"

While the available resources of a farm business are limited in which case an owner of a farm business should try to acquire the optimum size of financial and other resources in order to involve in an optimum size of operation. Credit is one way acquiring additional capital. But the questions related to the amount, type and timing are very important for a farmer's decision in acquiring additional funds/capital/. How should a farmer decide how much credit to use in the farm operation and where to use it? What are the contributions that credit can make? What types of credit are available? How a farmer can work with a lender for successful credit?

These resources have various sources including internal and external sources. Sources of funds used to control capital assets can be classified as equity and non-equity or debt financing. **Equity capital** is the capital owned by the operator while **non equity capital** is the capital gained from debt financing. They include savings and retained earnings, gifts and inheritance, pooling equity capital through a partnership or corporation, leasing, contract farming, and borrowing.

### 2.1.1. Savings and Retained Earnings

Assume you get a certain amount of capital. Let its source be either from your own earnings, or borrowing from your friend or bank. Which source makes you more confident to use? Is there any source which makes you less confident?

Despite the growing financial barriers to farm business entry, ongoing farm business firms can use their own capital sources to improve and diversify their farms. However, accumulating the beginning equity base needed to start farming by saving part of one's earnings from farm or non-farm employment is difficult. Because of this limitation of equity capital, farm operators are required to use non equity capital.

### 2.1.2. Gifts and Inheritances

Because of the dominance of family farm in most countries' agriculture, much of the owner equity in agriculture can be acquired through gifts and inheritances from the previous generation of farm operators. The disadvantage of this type of source of capital is that such funds are often not received when needed most. The availability of such funds for young farmers depends on the average life expectancy in a country.

### 2.1.3. Pooling Equity Capital

 There are several methods of combining equity capital in a farm business. One of the most common is the case where older farmers furnish capital to younger family members through partnership, incorporation, or some other type of formal or informal agreement. Although these arrangements are usually made among members of the same family, two or more unrelated individuals can pool their equity in a farm business. Formal agreements are not always necessary to use the equity in an existing operation as a base for growth and expansion. Informal arrangements for exchanging labor for machinery or possibly renting land from a successful neighbor or relative can reduce the need for large capital investments and provide management assistance in the early years.

The primary advantages of pooling equity capital are to take advantage of economies of size and to distribute risk among two or more persons. Generally, the participants in a farm business venture should share profits in direct proportion to their respective contributions of labor, management, and capital. Failure to recognize this basic rule is almost certain to result in an unsatisfactory arrangement. Other essentials of a successful business organization involving two or more farmers include the following:

* The goals of all participants should be compatible;
* They should be capable of getting along together and respecting each other's judgment;
* The business must be large enough to provide an adequate living for all parties; and
* Good records, sound farm management, and common sense in the handling of money will help to avoid disagreement.

The pooling of equity capital follows various organizations including partnerships, and incorporation to pool capital from family members, and non-farm equity capital from nonfarm investors.

**Partnerships:** A partnership exists whenever two or more persons associate to conduct a non corporate business. Partnership may operate under different degrees of formality, ranging from informal, oral understandings to formal agreement. In forming a partnership, the participants should know and understand what is involved and give proper attention to legal aspects. Each person entering into a partnership assumes considerable responsibility for actions of the other partners.

**Corporation:** Acorporation is a legal entity authorized by law and is capable of doing business, making contracts, borrowing money, and the like, just as an individual proprietor. For this and other reasons, the services of a qualified attorney/lawyer/ are essential for incorporating a farm business. The advantage of a corporation from a financing stand point is that the owners have limited liability. There are also a number of disadvantages associated with incorporating a farm business, and they should be carefully and thoroughly considered. Management of the farm not in line with the interest of minority owners, and additional time, expenses, and taxes paid unlike other farm business organizations are some of the major disadvantages.

### 2.1.4. Leasing

A lease is basically a capital transfer agreement that gives the lessee (the user farmer) control over assets owned by the lessor for a specific period of time for an agreed-upon payment or rent. Leasing is an alternative to purchase an asset in order to acquire the services of that asset. By leasing an asset the lessee essentially acquires its use value from the lessor, who actually purchased and owns the asset.

There are various types of leasing facilities. The major types of leasing common in agriculture include financial lease, operating lease, and leverage lease.

**Financial lease** is a contract that is non-cancelable and the lease period is usually shorter than the useful life of the asset being leased. During the life of the contract all of the cost of the property plus financing and servicing charges should be recovered through periodic payments. The lease assumes complete financial responsibility for the leased asset; and, if operated successfully, the lessor or owner will recover original investment.

**Operating lease** is a service available for which there is an established leasing and second-hand market. Assets are leased over periods from around six months, shorter periods being more in the nature of plant hire, up to three years for most types of equipment and machinery. An operating lease may be alternative when a firm requires a machine for a relatively short period. The operating lessor's function in assuming the obsolescence risk in uncertain circumstances is comparable to an insurance contract.

**Under leverage lease** the lessee assigns his interest in a purchase order to lessor who agrees to advance only a portion of the total asset cost, and arranges to borrow the remaining portion from institutional lenders.

Leasing covers various assets including real estate, machinery, and livestock leasing.

**Real-estate leasing:** Leasing is a common way for farmers to obtain control of additional land. Real estate leases can be the share lease or the cash lease. With a share lease part of a crop or livestock production is paid to the lessor as rent. With cash leasing arrangements, the lessor is paid a specified cash payment and usually furnishes the land, building, and other improvements. The concepts of cash and share rent are sometimes combined in what is called standing rent. In this case, in place of cash, the rental payment is made in a fixed measure of products, i.e. the dollar amount of rent the lessor receives varies with the price of the product, as it would with share rent, but the amount of product he will receive is known in advance.

**Machinery leasing**: Purchase of machinery often with borrowed funds is the traditional method of acquiring control over farm machinery. However, rapidly rising machinery prices have prompted many farm operators to consider leasing as an alternative to ownership of farm equipment. It can be operating lease, or financial lease. An operating lease is a short term contract in which case the farm operator leases the equipment by the hour, day, week, and month, etc. The lessor is responsible for insurance, taxes, and major repairs, and the lessee covers variable expenses such as fuel, lubricants, and routine maintenance.

However, there are many variations of operating lease including custom hiring, an operating lease arrangement whereby the owner of the equipment furnishes the machine operator in addition to covering all operating expenses, and a full-service lease, an operating lease contract under which the lessor assumes total responsibility for all repairs and maintenance costs. The financial lease, in contrast to the operating lease, is a long term contract under which the lessor essentially provides financing to the lessee. Usually the lessee is responsible for all repairs and maintenance just as if he had purchased the equipment outright.

**Livestock leasing:** The typical livestock-share lease contract usually covers land, buildings, and livestock. These contracts cover basic herd livestock such as dairy cows, beef cows, and sows. The lessor assumes fixed ownership costs including depreciation, taxes, and interest on investment, while the lessee is responsible for variable costs such as feed, housing, veterinary services, and labor.

**Advantages of leasing to the lessee:** Some of the merits of leasing from a lessee's point of view are the following:

1. Asset procurement: Leasing may be the cheapest means of obtaining the use of the most suitable machinery or equipment because of import or export controls or patent rights.
2. Additional source of finance: By leasing, the use of asset is obtained without capital outlay. It also raises debt capacity of the firm as additional source of finance.
3. Certainty: It has the fixed nature of a leasing contract to the lessor and to the lessee. This assures the availability of an asset with certainty.
4. Flexibility: Leasing arrangements are very flexible.
5. Convenience: Leasing is regarded by lessees as a simple and convenient method of financing the acquisition of capital assets.
6. Disposal problem: There is no disposal problem associated with leasing.
7. Higher incomes: An operating lease tend to inflate the incomes of early years of life compared with the expenses resulting from buying the asset.
8. Step-by-step financing
9. A well-defined cost
10. Maintenance is cheap and certain: With leasing the maintenance may be contracted and this contract may be attractive.

**Disadvantages of leasing to the lessee:** The advantages of leasing over other forms of finance in any given circumstances need to be weighted against the possible disadvantages listed below:

1. Ownership flexibility: A purchaser of asset avoids any of the restrictions found in leasing agreements concerning the operation of the asset and the requirement to obtain the lessor's approval to the insurance arrangements.
2. Residual value: A lessee gives up some or all of the benefit of the residual value of the asset at the end of lease period.
3. Security value: A lessee is unable to include the leased asset in a pool of assets which is then available as security for general borrowing.
4. Understatement of assets: The right to use asset for a major part of its useful life is an intangible asset which is not shown on a lessee's balance sheet unless leased assets are capitalized at economic value.
5. Prestige: Ownership may be thought to be prestigious and to give an emotive sense of satisfaction denied to lessees

### 2.1.5. Contract Farming

An increasing amount of resources used in the farming sector can be furnished by farm input suppliers, processors, and distributors under various types of producer contracts. Contract faming is, therefore, a way for an operator to obtain additional funds.

Forward contract refers to a futures contract to buy or sell a specific physical commodity at some time in the future. There are three basic types of forward contracts used in farming namely market specification contracts, production-management contracts, and resource-providing contracts. When the traditional open-market form of market coordination fails to provide the needed market outlet for input suppliers or farm products of the proper specification at reasonable prices for marketing firms, market specification contracts can be used. It is an agreement under which farm inputs or products will be exchanged at some specified future date at an agreed-upon price (or basis for calculating price). This contract specifies the acreage to be grown, the price per ton, and in some cases the delivery schedule.

Production-management contracts provide the same features as market specification contracts, but in addition the farmer receives technical advice and management services from the input supplier or processor. Market specification and production-management contracts typically do not provide any financing per se; however, they do have financial implications for the farmer because lenders tend to look more favorably on a loan application if marketing arrangements are guaranteed by a producer contract. Under resource-providing contracts the farmer receives financing from the marketing firm as well as guaranteed market outlet and production-management assistance.

As with any method of acquiring control of assets, contracting has its weaknesses and strengths. The most important advantage is the financing the farmer receives both directly from the contracting firms and indirectly through other lenders, who are more assured of loan repayment when a contract is in existence. In addition to financial help, the farmer usually receives managerial advice and technical assistance such as production scheduling, high-quality breeding stock and seed varieties, fertilizer recommendation, veterinary services, custom-blend feed, the latest equipment, and other supplies and services that might not otherwise be available. Contracting also leads to better coordination of production and marketing phases, thereby resulting in higher profits and reduced risk for both farmers and contracting firms.

Perhaps the most obvious disadvantage of contract production is the loss of managerial control. The farmer may become little more than a hired hand and may also have to accept lower net returns to compensate the contracting firm for providing financing and sharing production and marketing risks. Finally the farmer loses the opportunity to benefit from higher market prices if forward prices are specified in the contract.

### 2.1.6. Borrowing

Borrowing constitutes the remaining method of farmers use to acquire funds. The word 'borrow' means to receive some thing with the understanding that it or its equivalent will be returned as agreed upon. Stated another way borrowing means the ability to command capital or services currently for a promise to repay at some future time. In terms of money, borrowing involves obtaining a certain amount of funds to be repaid as specified in the note. Borrowing is not the exact synonym of credit.

## 2.2. Concept, Role and Classification of Credit

### 2.2.1. Concept of credit

According to the free on line dictionary, credit means Faith/believe/ and it comes from the Latin credito. An agreement, by which something of value-goods, services, or money-is given in exchange for a promise to pay at a later date. Credit is a transaction between two parties in which one, acting as creditor or lender, supplies the other, the debtor or borrower, with money, goods, services, or securities in return for the promise of future payment. As a financial transaction, credit is the purchase of the present use of money with the promise to pay in the future according to a pre-arranged schedule and at a specified cost defined by the interest rate

It was also defined by Ellis (1992) that credit is a sum of money in favor of the person to whom control over it is transferred, and who undertakes to pay it back. Moreover, Beckman and Forster (1969), defined credit as the power or ability to obtain goods or services in exchange for a promise to pay later. Similarly, it is a power or ability to obtain money by the borrowing process, in return for a promise to repay the obligation in the future.

Credit does not necessarily require [money](http://en.wikipedia.org/wiki/Money). The credit concept can be applied in barter economies as well, based on the direct exchange of goods and services. However, in modern societies credit is usually denominated by a [unit of account](http://en.wikipedia.org/wiki/Unit_of_account). Unlike money, credit itself cannot act as a unit of account

Since credit is a resource that can be used or held in reserve, borrowers and non borrowers alike are concerned with several questions. For example, a farmer might ask: How much credit is available, and how much should be used? What are the costs of credit? What are my legal obligations as a borrower? Which lender is most likely to be able to serve my credit needs?

**How much credit?** Credit use will increase return to equity and firm growth rates as long as the rate of return on capital invested exceeds the cost of borrowing. However, financial risk limits the amount of credit one can actually use without jeopardizing the survival of the business. The question can be answered by understanding the factors that lenders consider in evaluating loan application.

**Credit costs:** Borrowing involves several costs, including finance charges, legal fees, closing costs, etc., and it is sometimes difficult to identify and compare these costs. The only meaningful way of measuring the cost of credit is to express all charges and fees in terms of a compound annual rate of interest.

**Legal aspects:** Since widespread access to reasonably priced credit is vitally important in the growth and development of a market economy, a standardized set of laws, regulations, and procedures has evolved that protects the rights of borrowers and lenders.

**Sources of credit:** If there is widespread use of credit, there will be many borrowers with different needs and characteristics. As a result, specialization among lenders will be developed so that all borrowers will be served efficiently.

### 2.2.2. Bases of Credit

Numerous factors influence the creditworthiness /considered suitable to receive commercial credit/Credit is in turn dependent on the reputation or [creditworthiness](http://en.wikipedia.org/wiki/Creditworthiness) of the entity which takes responsibility for the funds/of a farmer. Lenders, especially bankers, use a formula known as the seven C's of credit when evaluating a credit application. Understanding them will help you make your applications as attractive as possible. Which mean credit managers usually talk of the C's of credit: character, capacity, collateral, capital, condition, courage, and competition?

1. **Character**: Character or integrity is the most important factor of confidence. This is essentially a summary of the individual. Creditors look for people who appear to be trustworthy and reliable, and who are willing and able to meet their financial obligations. The first step in selling one's credit to a lender is to be honest in all business and personal dealings, because the confidence factor is vitally important.
2. **Capacity (or risk-bearing ability**: Risk-bearing ability measures whether the farm operation can withstand financial losses without being forced into liquidation or insolvency. If production and prices decline and losses occur, they must be absorbed or covered by equity capital or net worth. The basic document used to measure the risk-bearing ability of the farm business is the balance sheet. The key ratios used in the analysis of risk-bearing ability are those related to total assets, or debt to equity. These ratios show the proportion of the business financed with debt compared to owner's equity and thus indicate the claims by others on the asset if liquidation should occur. This simply means the individual's ability to repay the loan; it is based on present and anticipated earnings balanced against existing debts.
3. **Collateral**: Collateral security is any security (other than personal security such a guarantee) taken by a bank or lender when it tends to make an advance to a borrowing customer, and which it is entitled to claim in the event of default. Hence, the presence or absence of collateral matters to get credit. The item pledged by the borrower as security for the loan, which may be real state, stocks, savings, a mortgage, etc.
4. **Capital (or repayment capacity):** A lender wants to be paid in cash; he has little interest in repossessing the security or collateral as satisfaction of the debt obligation. The ability to repay a loan is consequently an important determinant of whether credit should be extended and is influenced by the income-generating capacity of the business; the liquidity of the farm as indicated by the balance sheet, and the cash flow of the firm. In short run an indication of repayment capacity is that if current assets are not sufficient to pay current liabilities a repayment problem will very likely occur as an indication of repayment capacity in short run. In long run the key issue is whether there is sufficient revenue after paying for operating expenses, family living, and farm expansion to repay any debt obligation. This is the net worth on an individual as indicated by a personal financial statement
5. **Condition (or return)**: It is a combination of all the relevant facts about an agribusiness firm and its situation in the existing economic environment.The basic question with respect to returns is whether or not the use of credit will add to potential profits. Only if the profits of the business will be increased will there be additional income available to make principal and interest payments on the borrowed capital. Two questions are of interest in evaluating income or returns. The first is the issue of whether the planned use of credit is the most profitable use in the farm business. The second question with respect to the returns is whether the farm business is generating an adequate income to compensate for contributions of family labor and management as well as for equity accumulation. The profitability of the entire farm operations must be evaluated to assess the possibility of income generated from profitable enterprises to cover losses on unprofitable ones. Both regulatory and economic conditions are considered. Regulatory conditions apply to the lenders individual circumstances; for example, when banks are not lending in specific areas. Economic conditions determine the lender's general policy towards loan. Both are affected by the current economic cycle.
6. ***Credit*:** this is the individual's credit history
7. **Competition**: The extent of competition to extend credit also matters to get credit. If there is no sufficient number of competitors involved in the financial market (in credit extension), getting credit may be difficult and vice versa.

### 2.2.3. Role of Credit

At a certain stage in agricultural development, agricultural credit clearly does become a strong force for further improvement –when a man with energy and initiative who lacks only the resources for more and more efficient production is enabled by the use of credit to eliminate the one block on his path to improvement. Financial credit is the most flexible form of transferring economic resources to the poor. One can buy anything that is for sale with cash obtained through credit

According to Kebede (1995), credit makes traditional agriculture more productive through the purchase of farm equipment and other agricultural inputs, the introduction of modern irrigation system and other technological developments. Credit can also be used as an instrument for market stability. Rural farmers can build their bargaining power by establishing storage facilities and providing transport system acquired through credit. Credit plays a key role in covering consumption deficits of farm households. This would, in turn, enable the farm family to work efficiently in agricultural activities. Credit can further be used as an income transfer mechanism to remove the inequalities in income distribution among the small, middle, and big farmers. Moreover, credit encourages savings and savings held with rural financial institutions that could be channeled to farmers for use in agricultural production. Credit also creates employment opportunities for rural farmers.

Additionally, credit is important and necessary in nearly all commercial and individual farm businesses. The potential to improve net farm income should be one of the determining factors in the decision of whether to use credit. Credit can contribute in the improvement of net income in several ways:

1. Create and maintain an adequate size. Most farms exhibit decreasing costs as the size of the business increases because of economies of size;
2. Increase efficiency. Use of credit increases substitution, utilization of idle resources, and intensity of production to secure efficient use of resources;
3. Adjust to changing economic conditions of technology and market;
4. Meet to seasonal and annual fluctuations in income and expenditures;
5. Protect against adverse conditions of weather, disease, and price; and
6. Provide continuity of business during transfer.

### 2.2.4 Types of rural credit

There is typically a dual rural credit market in developing countries, formal and informal credit. In the formal credit markets institutions provide intermediation between depositors and lenders charge relatively low rates of interest that usually are government subsidized. In informal credit markets money is lent by private individuals, professional moneylenders, traders, commission agents, land lords, friends and relatives.

Formal and informal credits are imperfect substitutes. In particular, formal credit, whenever available, reduces, but not completely eliminates, informal borrowing. This suggests that the two forms of credit fulfill different functions in the household’s inter-temporal transfer of resources.

 Informal credit is used perhaps for consumption-smoothing purposes, while formal credit is sought and used mostly for agricultural production purposes and investment in non-farm income generating activities. The empirical evidence also suggests that the imperfect substitutability between formal and informal credit reflects to some extent the existence of due dates and conditionality on informal loan contracts.

### 2.2.5. Features/characteristics/ of Successful Agricultural Credit Provider

An institution that is successfully providing agricultural credit; amongst other financial services should have the following key features of success:

1. Household as a financial unit: Treating the farm household as a financial unit integrating a variety of economic activities, and basing lending decisions on repayment capacity rather than how funds are utilized;
2. Managing systemic risk: Managing systematic risk in agriculture by three levels of diversification: (1) across rural and urban branches; (2) across both agricultural and non-agricultural activities in rural branches; and (3) across diverse household economic activities;
3. Long term relationships: Long-term relationships to lower transaction costs for both lenders and borrowers;
4. Various types of collateral: Using various types of collateral, including collateral from poorer households;
5. Decentralized decision making: Delegated and decentralized decision making by well trained loan officers;
6. Regular monitoring: Regular monitoring of clients to ensure that repayment capacity is not jeopardized, opportunities are realized, and the borrower-lender relationship is strengthened;
7. Management and information system: An effective management and information system and a commitment to high loan recovery (including seizure of collateral where necessary as a signal to other clients); and
8. Adapting more flexible rural services: Adapting rural services to become more flexible in timing, amounts disbursed and repayment schedules – (bi-monthly, trimester, semester, annual, end of crop cycle and irregular repayment schedules).

### 2.2.6. Classification of Credit

There are many different types of business credit, and proper classification will facilitate communication and financial analysis. Primary classifications are presented here based on time and purpose

**Classification by time:** Based on the length of the terms of loans, credit can be classified into three:

1. Short-term credit (production credit):
	* Monthly credit (0-3 months);
	* Seasonal credit (3-9 months); and
	* Annual credit (9-1 year).
2. Intermediate-term credit: 1-10 years.
3. Long-term credit: Real-estate credit (more than 10 years).

**Classification by purpose**: This classification can facilitate analysis of the profitability of a specific loan if records as to income and expenses are kept.

1. Production loans (short-term and intermediate-term loans): Used to buy inputs, pay operating expenses, buy feeder livestock, range livestock, dairy cattle, machinery, and finance storage.
2. Real-estate loans (long-term loans): Used to purchase a farm, additional land, finance buildings, drainage, irrigation, and other permanent or long-life improvements.

## 2.3. Advantages and Disadvantages of Credit

### 2.3.1. Advantages of Credit

Modern economy is said to be a credit economy. Credit is of vital importance for the working of an economy. It is the oil of the wheel of trade and industry and helps in the economic prosperity of a country in the following ways:

1. **Economical**: credit is used as an engine/motor/ of the economy
2. **Increases productivity of capital**: Credit increases the productivity of capital. People having idle money deposit it in banks and with non-bank financial institutions which is lent to trade and industry for productive uses.
3. **Convenient:** Credit instruments are a convenient mode of national and international payments. They help in transferring payments with little cost and without the use of actual money from one place to another quickly.
4. **Internal and external trade:** As a corollary to the above by facilitating payments quickly, credit helps in the expansion of internal and external trade of a country.
5. **Encourages investment**: Credit is the payment along which production travels, and that bankers provide facilities to manufacturers/farmers/ to produce to full capacity. Credit encourages investment in the economy. Financial institutions help mobilizing savings of the people through deposits, bonds, etc. These are, in turn, given as credit to trade, industry, agriculture, etc. which lead to more production and employment.
6. **Increases demand:** A variability of cheap and easy credit increases the demand for goods and services in the country. This leads to increase in the production of such durable consumer goods. These raise the standard of living of the people when they consume more goods and services. Consumption loans by banking and non-banking financial institutions coupled with the use of credit cards have made these possible.
7. **Utilizes resources**: Credit helps in the proper utilization of a country's manpower and other resources. Cheap and easy credit encourages people to start their own businesses which provide them employment. Agriculture develops when farmers get seeds, fertilizers, pumping sets, tractors, etc. on credit. Similarly transport, communications, industry, mines, plantations, power, etc. develop with the help of credit.
8. **Price stability:** Credit helps in maintaining price stability in a country. The central bank controls price fluctuations through its credit control policy. It reduces the credit supply to control inflation and increases the supply of credit to control deflation.
9. **Helpful to government:** Credit helps the government in meeting exigencies or emergencies when the usual fiscal measures fail to fill the financial needs of the government. Government resorts to deficit financing for economic development by creating excess credit.

### 2.3.2. Disadvantages of Credit

Credit is a dangerous tool if it is not properly controlled and managed. The following are some of the defects of credit:

1. **Too much and too little credit harmful**: Too much and too little of credit are harmful for the economy. Too much of credit leads to inflation which causes direct and immediate damage to creditors and consumers. On the contrary, too little of credit leads to deflation which brings down the level of output, employment and income.
2. **Growth of monopolies**: Too much of credit leads to the concentration of capital and wealth in the hands of a few capitalists. This leads to growth of monopolies which exploit both consumers and workers.
3. **Wastage of resources**: When banks create excessive credit, it may be used for productive and unproductive purposes. If too much of credit is used for production, it leads to over capitalization and over production, and consequently to wastage of resources. Similarly, if credit is given liberally for productive purposes, it also leads to wastage of resources.
4. **Cyclical fluctuations**: When there is an excess supply of credit, it leads to a boom. When it contracts, there is a slump. In a boom, output, employment and income increase which lead to over production. On the contrary, they decline during a depression thereby leading to under consumption. Such cyclical fluctuations bring about untold miseries to the people.
5. **Extravagance**: Easy availability of credit leads to extravagance on the part of people. People indulge in conspicuous consumption. They buy those goods which they do not need. With borrowed money, they spend recklessly on luxury articles. The same is the case with businessmen and even governments who invest in unproductive enterprises and schemes.
6. **Speculation and uncertainty:** Over issue of credit encourages speculation leading to abnormal rise in prices? The rise in prices, in turn, brings an element of uncertainty into trade and business. Uncertainty hinders economic progress.
7. **Black money:** Excessive supply of credit encourages people to amass money and wealth. For this they tend to adopt underhand means and exploit others. To become rich, they evade taxes, conceal income and wealth and thus, hoard black money.
8. **Political instability:** Over issue of credit leading to hyper-inflation leads to political instability and even the downfall of government.