

## **Treatment of Informal Sector Financial Activities including Own Money Lenders in the SNA**

*Executive summary: At present the position of 1993 SNA on the treatment of activities of money lenders is not clear in that at para 6.134 it says that lending own funds is not production but at para 25 (Annex I) it is clearly mentioned that 'money lenders who make loans from their own resources are also considered producers of financial services provided their services can be measured.' Following the recommendation at para 6.134 of the SNA may lead to underestimation of GDP in developing countries where the money lenders who make loans from their own resources are quite prevalent. AEG need to take a view as to whether the activities of the own money lenders (who form part of the financial unorganized (informal) sector of the economy) could be considered as producers of financial auxiliary service in the system.*

1. The 1993 System of National Accounts (1993 SNA) documents the unincorporated financial activities and Money Lenders basically in just two paragraphs, namely 6.133 and 6.134 reproduced below:

*6.133. The output of unincorporated financial intermediaries, including those whose activities are not monitored and subject to regulation by central banks or other authorities is measured in the same way as for financial corporations. Money lenders who incur liabilities on their own account in order to mobilize funds which they lend to others are clearly engaged in financial intermediation. Their output must be measured by the difference between the property income they receive from the lending of borrowed funds and the interest paid on the borrowed funds. As in the case of large corporations, the income they receive from the investment of their own funds is excluded from this calculation.*

*6.134. Some money lenders lend only their own funds. The activity of such small- scale money lenders, including many village money lenders, is not financial intermediation as they do not channel funds from one group of institutional units to another. Lending as such is not a process of production and the interest received from the lending of own funds cannot be identified with the value of any services produced.*

2. The position of 1993 SNA on money lenders who make loans from their own resources becomes confusing if one takes a note of changes in 1993 SNA mentioned clearly in the Annex 1 of 1993 SNA in paragraph 25, 'Money lenders who make loans from their own resources are also considered producers of financial services provided their services can be measured'.

3. The 1993 SNA recommendations made in *paragraph 6.134* in a way imply that the developing countries having large informal sector (including the own account and unincorporated enterprises engaged in informal financial activities) activities in position will further underestimate the contribution of informal sector to the extent of own money lenders activities to their economy. In many Asian and African countries the size of the informal financial activities is not insignificant; in fact it is quite substantial and already underestimated due to non-availability of accurate statistics on them.

4. For example in India the workforce in the unorganized (informal) sector for the financial activities was estimated at 993,000 in 1993-94. Due to non-availability of requisite statistics in India the domestic product of this unorganized (informal) activity is estimated as one third of the domestic product of non-banking financial companies in the system. Though a study undertaken by the Reserve Bank of India quite some time back indicated that the actual dimension of the activity could be much larger, may be three times instead of one-third. However India still takes the contribution of unorganized (informal) financial activity as one-third of the contribution of non-banking financial companies in its estimates of national accounts. As per current National Accounts Statistics of India the contribution of unorganized (informal) financial activity is shown in the following table for illustrating the dimension of the issue.

**Gross Domestic Product at current and constant (1993-94) prices**

[in Rs.10 million (crore)]

item	2002-03		2003-04	
	Current price	Constant price	Current price	Constant price
Total banking activity	130896	79270	143592	85382
Of which Non-banking financial institutions	46387	31889	53010	33607
Unorganized (informal) financial activity	11597	7972	13253	8402
% of informal financial activity to total banking activity	8.8%	10.0%	9.2%	9.8%

5. The above numbers are given just for illustration of the fact that this unorganized (informal) financial activity is still prevalent in many developing countries in the Asia, Africa and may be other continents as well. Informal discussions with the national accountants of several developing countries revealed that the dimension of the issue is not insignificant

6. The workforce engaged in financial unorganized (informal) activities basically do the money lending or associated financial auxiliary services adopting several informal techniques such as pawn shop, chit funds, sahukar (money-lender), mataka (several local names), etc and many times employ some people to help in organizing the job, keeping records of transactions/documents/items/valuables of the borrower and for realizing back the money lent. Remuneration paid by own money lender to people employed by him to take care of his activities is obviously a component of the value added generated by money lender. In such a situation the recommendation at para 6.134 seems in-fructuous.

7. Own money lenders receive income for the service rendered in the name of interest that is not the real rate of interest of the capital money (return to capital), but much larger (at times five to ten times than the real rate of interest). They use the income received for meeting the expenditures of their business including payments made to employees (part or full-time) and of course for their own share of surplus. The important point to ponder is that it is not just the money lending activity from own funds or borrowed funds but the associated services that the user of the service (borrower) gets at his village/ site at the time when he/she needs. The user is prepared and pays for the services in the name of interest (along with the hidden huge service charges) as he has practically no other option to get the service (money) in his place at the time when he needs the money. In developing countries even in the urban areas as well, a large number entrepreneurs in business do borrow money required for running their business from own (informal) money lenders. Such situations generally do not exist in developed countries where facility of financial institutions is conveniently accessible to every one.

8. The unincorporated financial intermediaries including informal activities mentioned above are to be included as formal financial intermediaries as per *SNA para 6.133*. But as per guidelines of *SNA para 6.134*, if the money lender did not formally borrow money, the activity is not a Production and thus gets out of the production boundary. The practical problem is that in the developing countries in regard to the activities of the financial unorganized (informal) sector, it is never clear that the money lender did or did not borrow money for pursuing his activity. Moreover it could also be argued that the money lender used money of his relations (of course in the same household) and not his own money for pursuing his business.

9. The options to overcome the problem of underestimation of the activities of the financial unorganized (informal) sector and particularly that of the own money lenders in the developing countries are either to consider the activity as financial intermediary service, or to consider activities of the financial unorganized (informal) sector as just financial auxiliary service. In the later case when the users are in business and if they borrowed money for their business, the interest they pay need to be considered as service charge only (as the activity is not considered as financial intermediary service). Theoretically we shall be overestimating the service if we take the interest paid by the business as the service charge. Actually the correct service charge in this case would be the amount paid by the business minus the actual return to the money capital (which could be taken on the basis of the reference rate of interest). In practice in the developing countries, the money lenders mainly charge for their service, as the amount of interest

rate they charge is too high as compared to the true rate of interest. In case of households who borrowed money for personal use, the interest (including service charge) paid would be considered as final consumption expenditure. I for one would like to attach preference to the second option, i.e., considering the activities of money lenders who make loans from their own resources as producers of financial auxiliary services. The proposition that comes out of the above discussion is that the units which provide financial services exclusively with own funds be considered financial corporations and they will thus be productive in the sense of SNA as they provide loans to a range of clients and incur the financial risk of the debtor defaulting. Own money lenders may not be producing intermediation service but they are certainly producing financial services and run the risk of debt defaulting.

10. It need to be clarified that the money lenders who make loans from their own resources are suggested to be considered producers only because they happen to mainly provide the service to the borrower at the time of their requirement at their convenience. It should not therefore be argued to consider the property income earned by insurance/ financial corporations on their own funds as production under any circumstances.

11. In short there is an important need to clarify the position by the AEG in the SNA Update exercise in regard to the treatment of activities of the financial unorganized (informal) sector (including own money lenders) to avoid the problem of under estimation of GDP in the developing countries.

**Point for consideration of the AEG:**

*Do the members of AEG agree that the activities of the own-money lenders be considered as producers of financial auxiliary services?*

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