INFORMAL CREDIT IN TANZANIA: EVIDENCE FROM A CASE STUDY IN NORTHERN TANZANIA[1]

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Abstract

This article reports results of a survey on informal credit sources and uses in Tanzania's northern region of Arusha. The survey covered a random sample of 260 rural households, out of which 160 reported informal credit use. These were by order of importance: friends, relatives, family members and neighbours. Out of the reported sources, friends were the major source of credit in all the three districts that were sampled for the study. The set of borrowers included both rich and poor households, but unexpectedly, the former dominated in the use of informal loans. The informal loans accessed were in cash, physical assets and labour. These were preferred to formal loans because they involved low transaction costs and little or no explicit interest rate charges. Consumption was the major reported use of informal loans. Nevertheless, some informal loans were also used to finance farm activities, children's education and even payment of taxes. Overall, the mean and median size of the informal loans were very small, but the loans accessed served to smooth income over the crop production cycle in the sampled rural households. Thus the informal credit sources "complemented" the inaccessible formal credit sources by offering consumption loans and working capital. The manner of informal loan transactions underscores the importance of trust and reciprocity in rural debt contracts. Moreover, the size and uses of informal loans in the sampled areas serve to show the importance of small loans for direct consumption, children's education and working capital in strategies that target to develop the rural financial markets (RFMs). The types of informal lenders established by the study bears no potential for acting as "middle-rung" agents for expanding the outreach of formal financial services in the rural areas in and beyond the sampled areas in Tanzania.

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Key Words: Rural finance, informal credit, formal finance, rural financial markets.

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1. Introduction

At the attainment of political independence in 1961, agriculture was the major productive sector in Tanzania. The sector accounted for 53% of the total monetary Gross Domestic Product (GDP) and over 40% of the total foreign exchange earnings, largely from traditional export crops that included coffee, cotton, and sisal. It was obvious therefore that future economic development and growth was to depend on the performance of the agricultural sector. However, the majority of the rural population, among others, was characterized by a high incidence of poverty. Moreover, the technology employed in agricultural production was and is still quite old as it is characterized by use of hand hoes, matchet *(panga)*, and household labour that offers limited scope for increased productivity (Seidman, 1974).

The need to increase agricultural productivity and redress severe and widespread poverty amongst the majority of the population prompted the first post-colonial Government in Tanzania (then Tanganyika) to adopt a rural development strategy that emphasized the supply of credit to small-scale peasant farmers[2]. The supply-led institutional credit for the small-scale farmers in Tanzania rested on the then conventional arguments used to justify the World Bank supported credit schemes for small-scale farmers in other developing countries (World Bank, 1975:54). The basic argument was that the small-scale farmers lacked savings for capital formation in agriculture, mainly because they were poor (Ndulu and Msambichaka, 1982:11; Nyirabu, 1981:65). In addition to the implied "poor to save hypothesis", it was argued that the supply-led institutional formal credit was also necessary to save the peasants farmers from unscrupulous informal creditors who charged exploitative interest rates (Ndulu and Msambichaka, 1982:11; Nyirabu, 1981:65). In the context of the traditional arguments for institutional credit, institutionalized concessionary credit scheme was also necessary to help jump start productivity in small-scale farming and, therefore help eradicate poverty amongst the peasant farmers in Tanzania.

Even though increased access to agricultural credit could help eradicate poverty in the rural areas, most of the arguments used to justify the institutional agricultural credit for the small-scale farmers in Tanzania and other developing countries have fallen before empirical evidence from micro-surveys. Numerous studies have demonstrated the existence of savings and savings potentials and even attested to use of informal loans even where formal credit sources have been in existence (Nelson, 1999; K-Rep, 1997; Ndanshau, 1998; Donald, 1976; Lele, 1975). More specifically, the poor, to save the argument that was used to justify low subsidized credit, has been "dispelled by the

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[2]The strategy lasted between the attainment of political independence in 1961 and adoption of comprehensive financial sector reforms in 1991; and, it was marked by an institution of special agricultural credit finance institutions that during the period were transformed into a bank known as Tanzania Rural Development Bank (TRDB), in 1972. The latter was re-organized in 1984 to form Cooperative and Rural Development Bank (CRDB), which was privatized and renamed CRDB (1996).

practices of informal money keepers, savings groups, and RoSCAs (Rotating Savings and Credit Associations) that exist in almost every developing country" (Owens and Wisniwiski, 1999:3).

2. The Data and Areas of the Study

The data used here is from a survey of informal and formal finance in the rural areas in Arusha region, Northern Tanzania (Ndanshau, 1996). The survey covered 256 rural households that were randomly sampled in three of the eight districts in that region. The data was collected by use of a structured questionnaire that was complemented by non-structured questions. The questionnaire was administered once to the head of the household; and, it comprised five main modules: demographic characteristics; income and expenditure; assets owned and how they were financed; modes of savings and their uses; and credit sources and uses. The analysis in this study is mainly based on the data from the demographic and credit modules of the questionnaire.

The sampling areas were in three agro-economic and climatic zones. However, in all the sampled areas, agriculture was the main source of income (Table 1). In particular, crop production of coffee and maize were the main source of cash income in Arumeru and Babati districts, respectively. In contrast, livestock (milk, hides, and livestock sold) was the main source of income in the households sampled in Mbulu district. Since coffee is a perennial crop, it is not doubtful that the households in Arumeru experienced more seasonal variations in incomes than the households in Mbulu and Babati districts. The latter two districts depended on income from both food crops and more abundantly available livestock products that were sold in the local markets. It is noteworthy that cultivation of coffee demands more in terms of inputs including, pesticides, insecticides and fertilizer. As established by the survey, modern agricultural inputs were more used in Arumeru district than in Babati and Mbulu districts, where use of animal manure was more predominant, probably because of livestock keeping and poor access to institutional credit.

Table 1: Composition of Income in the Sampled Households (Percent of Total)

Source of Income	Arumeru	Babati	Mbulu	Overall sample
Crop production	50.2	60.8	33.4	52.7
Livestock	23.4	26.0	44.4	27.8
Off-farm employment	19.9	10.4	19.1	15.2
Transfers	5.4	1.5	2.2	2.8
Others	1.0	1.0	1.0	1.5
Total	100.0	100.0	100.0	100.0
Median	5,825.0	6,742.9	6,243.7	5,906.7

Source: Survey, 1989/90.

As a predominantly coffee growing area, Arumeru was a beneficiary of institutional credit disbursed by the now privatized Cooperative and Rural Development Bank (CRDB) to small-scale farmers through the Arusha Region Cooperative Union (ARCU) and the affiliated primary cooperative societies. Because of poor transportation infrastructure in the region, the ARCU concentrated its "activities in Arumeru district such that it was nicknamed Arumeru Cooperative Union". While the consequent disenchantment with ARCU led to establishment of Rift Valley Cooperative Union (RIVACU) for serving Babati, Arumeru, Mbulu and Ngorongoro districts in the region, the primary cooperative societies inherited from ARCU were financially weak. As a result, they failed to access bank credit for disbursement to their members, that is, the smallholder crop producers. Due to this problem the smallholder produces in Babati and Mbulu remained rationed by institutional credit supplied by CRDB. Logically, it is argued that self-finance and informal credit sources served as financial avenues for smoothing consumption and investment amongst the smallholder farmers, more so in Babati and Mbulu districts than in Arumeru district.

3. Informal Borrowing: Survey Results

3.1 Sources of Informal Loans

Out of the sample of 256 households covered by the survey in Arumeru, Babati, and Mbulu districts, 56% reported use of informal loans in the year that preceded the survey (Table 2). The use of informal credit was variable across the sampled districts. In Arumeru district, informal borrowing was reported by about 59% of the respondents. In Babati and Mbulu districts, 56% and 49% of the respondents, respectively, reported the use of informal loans in the year that preceded the survey. This suggests the existence of more use of informal loans in Arumeru than in the rest of the surveyed districts. This could be explained by characterization of the sampled households sampled in Arumeru districts by relatively poor opportunities for smoothing income. The sampled households 'customarily' depended more on cash from coffee production a perennial crop, whose marketing under the cooperative movement was in trouble that required access to cash for, among other things, purchase of inputs and farm labour at varied stages of the crop cycle.

Table 2 shows that friends, relatives, family members and neighbors were the most important sources of credit in the districts surveyed in Arusha region. By ranking, friends were the most important source of credit in all the three districts surveyed as reported by 36% of the borrowers in the sample. The dominance of friends as the main source of credit across the three districts emphasizes the importance of social networks and the trust that they engender. In addition, however, it could be argued that friends were the most important source of credit because in rural communities, loans to relatives and family members are often mistaken with transfers, mainly because of the traditional insurance system and other social obligations including sharing of riches or even poverty! In this regard, the averse to risk of default would account for preference and easy access of rural households to loans from friends than their immediate family members.

Table 2: Reported Sources of Informal Loans by District

	District						Ovrall	
	Arumeru		Babati		Mbulu			
Sample size	124		93		39		256	
Actual borrowers	78		60		22		160	
% of Sample	64.5		62.9		56.4		62.5	
Credit sources	No.	%	No.	%	No.	%	No.	%
Friends	25	32.5	40	37.4	13	40.6	78	36.1
Relatives	9	11.7	17	15.9	9	28.1	35	16.2
Family members	5	6.5	17	15.9	1	3.1	23	10.6
Neighbours	3	3.9	14	13.1	6	18.7	23	10.6
Money-lenders	4	5.2	1	0.9	-	-	5	2.3
Cooperative societies	26	33.8	6	5.6	1	3.1	33	15.3
Others	5	6.5	12	11.2	2	6.2	19	8.8
Total	77	100.0	107	100.0	32	100.0	216	100.0

Note: Some columns do not exactly add to 100 because of a rounding- off error.
Sources: Survey 1989/1990.

It is also likely that loans from family members and neighbours were less reported due to limited lending capacity amongst them that could have resulted from their characterization by the same level of income and investment opportunities, owing to historical and climatic or ecological factors.

In sum, friends, relatives and neighbours supplied credit to about 74% of the actual borrowers in the sampled areas. This finding is similar to that established by some of the previous studies in Tanzania (Temu and Hill, 1994; Hyuha, Ndanshau and Kipokola, 1993; Kashuliza, 1993) and other LDCs (Udry, 1994; Aryeetey, 1995). In Tanzania, the study by Hyuha, Ndanshau and Kipokola (1993) finds the use of informal credit by 32% of the 262 households survey in 7 regions. Kashuliza (1993) finds the use of informal loans by 34% of 458 households sampled in the Southern Highlands. Moreover, according to Aryeetey (1995), an analysis of the Ghana Living Standards Survey (1988-89) indicates that about 90% of the loans taken by 1,000 households came from individuals, including relatives, friends and acquaintances (p. 12). Moreover, a study by Udry (1994) finds that 68.6% of the households surveyed in Nigeria had obtained loans from relatives, friends and neighbors and about 16% had obtained loans from traders. Furthermore, a study by Miller (1977) shows that 58% of 302 farmers surveyed in West Kwara State of Nigeria obtained credit from friends and relatives, and 24% from money lenders.

It is noteworthy, however, that the survey in the three districts in Arusha region lacks information about loans from landlords and crop buyers that feature in many of the subsequent studies in Tanzania. For example, Hyuha, Ndanshau and Kipokola (1993) and Bagachwa (1995) find that traders and landlords were some of the major sources of credit in Tanzania, and even in Arusha region. Moreover, Temu and Hill (1994) find that traders and business operators were a source of credit to farmers in Kilimanjaro region.

Some studies in other developing countries also provide evidence on loans from traders (Udry, 1994). The absence of traders, particularly crop buyers, as a source of credit in the areas surveyed in Arusha region could be attributed to centralized crop marketing system that existed in the country prior to its liberalization in 1991. Under the regulated crop marketing system, the private crop buyers operated in the parallel markets such that even where they advanced credit it was not "safe" for the respondents to report it. This explanation applies also to the moneylenders. Some of the previous studies in and outside Tanzania established existence of credit from the moneylenders (Hyuha, Ndanshau and Kipokola, 1993). However, this study shows that only 2.3% of the sampled households reported loans from the moneylenders. This could be attributed to illegality of money lending in Tanzania. This may have precluded reporting of loans from moneylenders by the sampled households in Arusha region.

3.2 Types and Size of Informal Loans

The types of informal loans accessed by the sampled households were diverse. Table 3 shows that the majority (37.4 percent) of the borrowers reported credit in the form of cash. Credit in the forms of goods and labor was respectively reported by 24.8% and

18.7% of the actual borrowers in the sample. Credit in the form of labor was particularly reported in Babati and Mbulu districts. According to Table 3, credit in the form of livestock and farm equipment were also important in the sampled areas. The credit in farming equipment (oxen/donkey-drawn plough and tractors) was important in the lowly populated Babati and Mbulu than in highly populated Arumeru district. All reported informal lenders extended diverse forms of credit (Table 3). This implies hat the informal lenders in the sampled districts lacked specialization. This suggests importance of reciprocity which is a form of security based on personal knowledge and closeness of parties involved (Christensen, 1993; Adams and Fitchett, 1992; World Bank, 1989). It is in this regard, that friends, family members, relatives and neighbours were the most important source of credit in cash (excluding moneylenders) and labor.

Table 3: Frequency Distribution on the Types of informal Credit by IFIs Reported (%)

Source	Friends	Relatives	Neighbors	Family members	Money lenders	Coop. Societies	Others[3]	Overall
Cash	39.7	34.3	26.1	56.5	100.0	18.2	41.2	37.4
Goods	11.5	17.1	34.8	8.7	-	78.8	11.8	24.8
Labor	24.4	17.1	26.1	34.8	-	-	5.9	18.7
Livestock	5.1	17.1	-	-	-	-	11.8	5.6
Farm equp[1].	10.3	5.7	4.3	-	-	3.0	23.5	7.5
Others[2]	9.0	8.6	8.7	-	-	-	5.9	6.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Some columns do not add to the row total because of a rounding-off error.

[1]Include donkeys, oxen, plough and tractor.

[2]Include beer brewing equipments

[3]Include shop-owners and distant households in and outside the village.

[4]This finding needs, however, to be interpreted cautiously because of the arbitrariness of the poverty lines adopted here.

By using an arbitrary poverty line (set at the 4th decile of per capital income), 42.4% and 57.6% of all actual borrowers were poor and rich, respectively (Table 4). This implies that both rich and poor rural households in the sampled areas used informal credit sources. The proportion (57.5%) of the rich households that reported the use of informal loans was larger than that of the poor households (42.4%) (Table 4). This finding was unexpected. The evidence suggests that the use of informal and formal loans in the sampled areas was not "class" specific.[4] Indeed, further evidence from the survey shows that a half of 10 households that reported the use of both informal and the formal loans were in the "poor" (low-income) strata and the remaining half was in the "rich" (high-income strata). Kimuyu (1996) obtained similar evidence on the use of both informal and formal loans by the rural households in Kilimanjaro region [5].

Table 4: Frequency Distribution of Informal Loans by Income Levels and Districts Surveyed

Size of Loans (TShs.)	Babati			Arumeru			Mbulu			Overall		
	No.	Poor %	Rich %	No.	Poor %	Rich %	No.	Poor %	Rich %	No.	Poor %	Rich %
100-500	13	10.3	6.4	6	1.7	8.3	3	9.1	4.5	22	6.9	6.9
501-1000	15	6.4	12.8	4	5.0	1.7	5	4.5	18.2	24	5.0	10.0
1001-1500	13	6.4	10.3	5	3.3	5.0	2	4.5	4.5	20	4.4	8.1
1501-2000	5	3.8	2.6	7	5.0	6.7	2	-	9.1	14	3.7	5.0
2001-3000	11	9.0	5.1	7	6.7	5.0	1	4.5	-	19	7.5	4.4
3001-5000	8	1.3	9.0	9	6.7	8.3	2	4.5	4.5	19	4.4	7.5
5001-10000	7	3.8	5.1	11	6.7	11.7	4	4.5	13.6	22	6.2	7.5
10001-15000	5	1.3	5.1	4	-	6.7	2	-	9.1	21	1.2	5.6
15001+	1	-	1.3	7	8.3	3.3	1	-	4.6	9	3.1	2.5
Total	78	42.3	57.7	60	43.4	56.7	22	31.8	68.2	160+	42.4	57.5

Source: Survey 1989/90.

A decile distribution of informal loans reported by the sampled households shows that 80 percent of them were Tshs. 10,000 or lower (Table 5). Moreover, in the case of the specific districts covered by the survey the average loans' size was Tshs. 3,099 in Babati, Tshs. 6,277 in Arumeru and Tshs. 4,071 in Mbulu. In the overall, the size of the informal loan accessed by the borrowers was Tshs. 4,417 and the median loans' size was Tshs. 2,010 (Table 5).

[5]Similarly, a study on Nigeria by Wai (1977) estimated at between 40% and 50% the share of credit from traders, middlemen, produce buyers and the money lenders.

Table 5: Decile Distribution of Informal Loans Reported by Districts Surveyed (TShs)

Decile	Babati	Arumeru	Mbulu	Overall
1	336	504	330	400
2	600	1220	600	660
3	900	1730	784	1130
4	1200	2560	1400	1500
5	1500	3620	1700	2010
6	2092	5000	3560	3000
7	2630	7000	6275	4370
8	4080	10000	7080	7160
9	9730	16000	12000	11540
Mean	3099	6277	4018	4417
Median	1500	3620	1700	2010
Stdev.	3925	7395	4398	5700

Source: Survey 1989/90.

The size of the informal loans reported by the majority (80%) of the borrowers in the sample was less that TShs. 10,000 (about USD 51 in 1990). Moreover, Table 5 shows that both mean and median size of the informal loans, that is TShs. 4,417 and TShs. 2,010, were far smaller than the median and mean size of the formal loans which was TShs. 16,500 (about USD 84) and TShs. 17,571 (USD 89), respectively. This small size of the informal loans accessed by the sampled households is not particular to this study. Bagachwa (1995) found that the smallest loan was TShs. 2,000 (USD 6.25); and, the size of the informal loans accessed tended to exhibit significant variations by, among others, the source and location.[6] Taking into account a view maintained by commentators on rural credit markets (Chandavarkar, 1985; Patrick, 1966), some respondents upheld a view that the informal financial institutions may undermine financial policy.

[6] Finding is similar to that established by some other sample survey studies in the Niger, Senegal and Zaire (USAID, 1989; Graham, 1989), Nigeria, Pakistan, Thailand an India (Soyibo, 1996; Oludimu and Fabiyi, 1983; Miller, 1997) and Tanzania (Bagachwa, 1995).

Three factors emerged from the interviews: one was the small size of the loans, which rendered them inadequate for credit needs of the households. Second, was uncertainty in accessing informal loans, especially during the lean months, when there is an increase in demand for loan. The third factor, is embarrassment from the failure to repay, also during the lean month when everybody wants to borrow. Moreover, it was reported in all the sampled areas that dishonesty has eroded the trust, which is central in credit transactions. As explained (in Mbulu district) "people, especially the youths, are not trustworthy nowadays. In the good old days, there was no need for collateral or a guarantor when one sought a loan. One could just go to another household in the village and take (borrow) a goat to solve one's own problems even in the absence of the owner. It was just a matter of communicating later that you had a problem and then promise to repay. This has changed. Yet, some respondents (in Singe, Babati) argued that "nobody can survive without borrowing". As a result, informal creditors remain indispensable given the existing poor access to FFIs by the rural households in the sampled areas in Arusha region in Northern Tanzania.

3.3 Uses of Informal Loans

Table 6 shows that there were at least three major expenditure items financed by informal loans. By ranking these included consumption expenditure (22.4%), farming activities (18.1%) and school fees (13.2%). Other expenditures financed by informal loans included medical expense (8.3%) and tax payments (7.3%). The use of informal loans to finance consumption expenditure was predominant in Babati (27%) and Mbulu (35%) than in Arumeru district where the majority (30%) of the actual borrowers had used informal loans to finance farming inputs (Table 6).

Thus, the results in Table 6 suggest that informal loans were not absolutely used for smoothening as traditionally believed. Rather, a significant proportion of the reported informal loans were also used to finance investment and productive activities-farming inputs (18.1%), farm purchases (5.4%), business trade (3.9%), purchase of livestock (5.8%) and housing (6.8%). In fact, if expenditure on school fees (children's education) is considered as an investment rather than a consumption item as upheld in the traditional theory, it is apparent that the proportion of informal loans used in direct and indirectly productive economic activities was even higher, both in the specific district and the overall samples. Suffice it to say that the use of informal loans to finance consumption and productive economic activities in the sampled areas is consistent with the findings from other studies in and outside Tanzania. In Ghana, for example, an analysis of the LSS showed that informal loans were mainly used to purchase consumer goods (25.4%), expand non-farm business (24.2%) and to invest in agriculture (11.2%) by purchasing land and other agricultural inputs Aryeetey, (1996:155). Similarly, a study by Hyuha, Ndanshau and Kipokola (1993) finds that most of the 262 sampled households in seven regions in Tanzania had borrowed to finance consumption (20.3%), crop harvest (24.5%), and purchase of farms (13.5%). According to Hyuha, Ndanshau and Kipokola use of informal loans to finance children's education was reported by 9.2% of the sampled households.

Table 6: Uses of Informal Loans by the District Surveyed (in Percentages)

	Babati	Arumeru	Mbulu	Overall
Valid Cases	114	88	34	160
Consumption (food)	27.1	11.2	35.0	22.4
Farming Inputs	11.8	30.0	7.5	18.1
Farm purchase	10.6	2.5	-	5.4
Business/Trade	2.3	6.3	2.5	3.9
Purchase livestock	8.2	1.3	10.0	5.8
Build a house	5.9	8.7	5.0	6.8
School fees	15.3	13.7	7.5	13.2
Medical	7.1	12.5	2.5	8.3
Wedding, Dowry, death	2.3	1.3	5.0	2.4
Tax payment	4.7	5.0	17.5	7.3
Other*	4.7	7.5	7.5	6.3
Total	100.0	100.0	100.0	100.0

Note: *Includes dip charges, livestock medicines and travel expenses.
Source: Survey 1989/90.

4.0 Informal Credit Use: The Push Factors

According to Table 7, there were other factors: easy access to informal credit (17.4%), lack of interest rates (15.7%), prompts disbursement of the informal loans sought (14.3%), absence of a need to travel (13.7%) and lack of requirement for security (13.1%) (Table 7). Notable is that, albeit of the poor outreach of the FFIs, lack of banks was not overly an important factor that prompted the use of informal credit sources in the sampled areas. Similarly, complexity of banking activities was a marginal factor that prompted the use of informal credit sources. The poor response here could be explained by two factors: first, only 40% of all the sampled households were informed of the major FFIs in Tanzania.[7] Apparently, the CRDB was least known in Arumeru districts than in Mbulu and Babati district. This is notwithstanding the fact that Arumeru district dominated in the formal agricultural credit supplied to the cooperative by the CRDB, mostly in the form of inputs to coffee and maize producers in Arusha region.[8] This implies, while the CRDB credit to small-farmers was supply-driven, poor dissemination of information by the co-operative movement undermined its capacity to augment its lending capacity and capital base by mobilizing savings from the beneficiaries of its loans. The limited lending base that is by and large dependent on donor and government funds, prompted rationing of loans (Ndanshau, 1996). Second, is the supply-driven agricultural credit, disbursed by the CRDB to the co-operatives for on lending to the small-scale farmers. The co-operatives borrowed from banks for on-lending to small-scale farmers. As a result therefore, the ultimate users of credit who are the farmers lacked knowledge on their creditors, namely, the CRDB. Thus, as a result of the manner in which formal credit was delivered and administered to the small-scale farmers in Tanzania, the farmers also lacked knowledge about their debt obligations.

Table 7: Motivations for the Use of Informal Loans by the Sampled Households (in percentages)

	Babati	Arumeru	Mbulu	Overall
Valid cases	78	60	22	160
Interest rate not charged	16.7	15.7	12.9	15.7
Security not required	15.0	9.3	18.8	13.1
Travel not involved	11.4	16.4	11.9	13.7
Easy to reach	18.3	17.7	13.9	17.4
Promptly attended	13.4	14.5	16.8	14.3
Habitual	3.9	3.2	6.9	4.0
Banks not available	10.5	6.7	10.9	8.9
Banks are complicated	6.5	8.0	4.9	7.0
Bribery informal credit	3.3	6.4	3.0	4.6
Others	1.0	1.9	-	1.2
Total	100.0	100.0	100.0	100.0

Note: The column may not add to the total because of a rounding-off error.
Source: Survey 1989/90.

[8]The remaining FFIs, namely THB, which has a limited infrastructure to provide credit and savings facilities, and NIC, which by its nature is specialized in insurance activities, were, respectively, known to only about 26 percent and 9 percent, of the sample. The poor knowledge on CRDB and its lending operations in Arumeru district was also evident from reported lack of knowledge by the sampled households about the size, repayment amount and period, and the interest rate charged on the CRDB loans supplied to the small-scale farmers by the cooperative movement (ARCU).

In the overall, Table 7 suggests that low transaction costs (travel required, easy access and prompt disbursement of informal loans) reported by 45.4% of the borrowers ranks first most important factor that influenced the use of informal rather than formal loans in the sampled areas in Arusha region. The second most important factor is lack of interest rates on informal loans, reported by 15.7% of the borrowers.[9] However, as in most other previous studies in and outside Tanzania, there were no explicit interest rates that were reported by the sampled households (Temu and Hill, 1994; Aryeetey, 1995; Hyuha, Ndanshau and Kipokola, 1993). Thus, lack of interest rate as the factor that prompted the use of informal credit sources serves to demonstrate its importance in the choice(s) of a lender(s) in the sampled areas. Averse to the risk of losing land was an additional factor that also influenced borrowing, especially in the scarce land and densely populated Arumeru district.

5. Conclusion

The objective of this article was to present empirical evidence on the sources and uses of informal credit by 160 of the 256 rural households covered by a survey in three districts (Arumeru, Babati and Mbulu) in Arusha region (Northern Tanzania) in 1989-1990 period. The results presented show that the main informal credit sources in the areas covered by the study, by order of importance, included friends, relatives, family members and neighbors. According to the findings, friends were a common source of credit across the sampled districts.

Moreover, the study shows that both poor and rich households, measured on the income scale, used informal loans. According to the findings, the proportion of the rich households that reported the use of informal loans was larger than that of the poor households. The reported credit in the sampled areas was both in cash and in kind, and this was partly used to smooth consumption and partly used in directly and indirectly productive economic activities (purchase of farms, crop harvest, school fees and taxes) over the crop production cycle. The use of informal loans was more prevalent in Arumeru where the sampled households depended more on income from a perennial crop (coffee) than in Babati and Mbulu district where sources of income over the crop cycle were more diversified. According to the findings of the study, lack of formal credit services was not an overly important factor in explaining the use of informal credit sources. Instead, low transaction costs and lack of interest rates were the most important factors that influenced the use of informal loans in the sampled areas. According to the survey, the reported informal loans were, by and large, very small but indispensable in the sampled areas. This was caused by constraints experienced by the sampled households in accessing the formal credit sources that could offer large loans for investment in agriculture and, thereof, contribute to an increase in income through an increase in agricultural productivity.

[9] A statistical test conducted showed that the loan amounts to the sampled households exhibited varied enormously; and, this was not correlated to the size of the household.. The correlation between informal loans and the household size was also negative. See Ndanshau (1996).

The findings of this study, as modest as they are, underscore the importance of credit in smoothing consumption and investment in the rural farming households that more often than not experience seasonal income shocks due to the risks associated with agricultural activities. Granted informal credit serves as an insurance, not only because of lack of formal credit, but also because of lack of a formally institutional insurance arrangement for farming households in Tanzania. Clearly then, the informal lenders play a positive role. However, by their nature, they are not likely to diminish with an increase in the outreach of formal credit sources. In addition, it could be argued that major informal sources of credit established by this study could be important but not convenient "middle-rung agents" for expanding the outreach of formal credit to the rural households in Tanzania. Instead, the evidence on the types and uses of informal loans reported in the areas covered by the study could be used by the quasi-formal and formal financial institutions to design strategies for the delivery of financial services to the rural areas in Tanzania.

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