SMALL FARMS AND AGRICULTURAL CREDIT: A STUDY
OF THE FACTORS AFFECTING ACCESS IN WEST BENGAL

Chapter 1

The Context of the Study

1.1. Introduction

Agriculture in India has gone through a vast change since Independence. The institutional and technological changes have transformed subsistence farming into commercial farming. Subsequently, with the adoption of modern technology the credit requirements for input and other working capital i.e., requirements for production credit has increased along with the requirement for consumption credit.

An effective agricultural credit system is an important prerequisite for sustainable agriculture. The agricultural credit system requires a huge volume of low-cost deposit that has to be lent at subsidized rates yet show profits and meet development targets. The rural borrowers (small farmers, marginal farmers and landless agricultural labourers forming over 66 per cent of the total borrowers) are generally affected adversely by the high interest costs for short-term crop loans. They are usually dependent on informal credit from small-scale moneylenders. There is almost complete lack of resources for longer term purposes, that is, to purchase animals and equipments, upgrade their stock, reclaim acreage, execute social conservation measures and finance similar capital needs. High-cost loans from moneylenders impose heavy financial
burden on their current income and consequently depress their living standards. Also non-availability of longer term credit prevents them from improving productivity.

It has been observed over the years that credit provided by informal lenders (registered/unofficial moneylenders, commission agents, traders/landlords etc.) is exploitative and expensive, especially for small farmers. Their monopoly needs to be counteracted by extending low-interest institutional credit. Although some progress has been made towards the institutionalization of credit, inequalities in the distribution of credit across regions and across size-classes of landholdings still prevail and money-lenders' activities are continuing. In the competition for a small quantum of formal credit sources, the poor lose out and are compelled to take resort to informal sources of credit. The latter source is quick, flexible and free from different sorts of formalities but carries other onerous terms affecting farmers' income and living standards.

1.2. The Present Study

The present study attempts to highlight the problems associated with the prevailing credit situation in West Bengal with a special reference to small and marginal farmers and to suggest certain measures which can have implications in the national context under similar circumstances.

West Bengal is one of such states of the country where institutional reforms have brought revolutionary changes in agriculture. The NSSO data show that there is no large landowner in West Bengal. In India, as a whole, households with large ownership holdings account for 0.6 per cent of the households and 11.6 per cent of all area owned. The corresponding figures for household operational holdings are 0.8 per cent and 11.8 per cent.
Secondly, in West Bengal, households with small and marginal ownership holdings account for 97.8 per cent of all households, and cover 83.9 per cent of all area owned. In India, as a whole, 90 per cent of all ownership holdings are small and marginal but these households own only 43 per cent of the extent of all ownership holdings. The situation is similar in respect of household operational holdings (NSSO, 2002-03).

Thirdly, it is interesting to note that medium landowners operate only 2.7 per cent of holdings in West Bengal, as there is no large land owner in the state, whereas medium and large landowners operate 34 per cent of total operational holding in the country as a whole. As per NSSO data West Bengal also shows the lowest Gini concentration coefficient of operational holdings of all fifteen major states (0.313).

In addition to land reforms, tenancy reforms have also been quite successful in the state. The Operation Barga programme, implemented in the state, protected the rights of sharecroppers. Nearly 1.5 million sharecroppers cultivating more than 1.1 million acres of land were registered under Operation Barga. West Bengal and Jammu & Kashmir were the most active states in distributing ceiling surplus land. The land distributed under land ceiling legislation in West Bengal accounts for one-fifth of the total land distributed in the country (Srivastava, 2006). Since 1977, West Bengal has also implemented a programme of giving security of tenure to sharecroppers.

There is no denial of the fact that agrarian reform requires non-land inputs like irrigation, credit, seeds, fertilizers, marketing and extension facilities. Land reforms in West Bengal have contributed to better adoption to high yielding technology, better access to inputs, high investment in tanks, bore well and pump sets and pressure on wages and thereby to high agricultural growth (Lieten, 1992, 2003, Bandyopadhyay, 2003, Boyce, 1987, Kohli, 1987). The
state is positioned very favourably so far as agricultural production is concerned. It ranks first in the production of rice and second in the production of potato.

In West Bengal, irrigated area as a proportion of net sown area expanded from 32 per cent to about 70 per cent over the last three decades. The cropping intensity in the state has touched the figure 180. The proportion of area under HYV seeds to total area under paddy increased from 26 per cent to 96 per cent.

Like other non-land inputs, an efficient credit delivery system providing timely and cheap credit to the farming community of West Bengal is one of the most important complementary requirements to enable them to undertake modern technology of production. In West Bengal, there has been substantial widening of banking network and credit disbursement by commercial banks has enhanced remarkably over the years. The concept of cooperative also holds a crucial position in planning and development matters in West Bengal. Along with short-term loan, a positive trend has been achieved in long term loan disbursed by cooperatives. The policy of universal membership of the cooperatives devised by the state aims at marginal farmers, landless labourers, sharecroppers and pattaholders. This has gone a long way in reducing the vested interests in the cooperative sector. Small and marginal farmers have greater representations in cooperatives. Marginal and small farmers receive about two-thirds of total credit disbursed by cooperatives, whereas it is only 30 per cent for the rest of the country.

Provision of micro finance facilities through Self Help Groups (SHG) is another noteworthy step in the state towards meeting the production and consumption credit requirements of marginal and small farmers.

In spite of all the instances of development, poverty and disparity of income are widely prevalent in rural Bengal. Pre-capitalist features of production relations still exist, which are
revealed in various forms like dominance of informal lenders in capital market, interlinked transactions, exorbitant rate of interest, forfeiture of collaterals in the case of default etc.

It is to be noted that the credit deposit (C-D) ratio in the state has been very low. The C-D ratio in the state has been lower than the all-India average and lower than many other parts of the country, especially the western and southern regions of India. The situation is even worse in rural Bengal. Savings are being mobilized in rural Bengal but are not invested there.

The annual percentage growth in the flow of institutional credit per hectare of Gross Cropped Area (GCA) was the highest for West Bengal (34.9%) among the states of the Eastern region in the decade following the Economic Reforms (RBI, 2004). But in spite of the growth in credit flow, the share of the state in total loan disbursement for agriculture has remained low (3.8%) as compared to many other states like Uttar Pradesh, Gujarat, Maharashtra, Kerala, Karnataka, Tamil Nadu, Andhra Pradesh, Haryana and Punjab (NSSO, 2003). It also needs to be mentioned here that the share of agricultural loan in total loan disbursed in the state (45.7%) has remained low compared to the national average (58.4%). It is observed that the outstanding loan per farmer household is low in the state (Rs. 5,237) compared to the national average (Rs.12,585) (NSSO, 2003). The reason behind this lower disbursement of credit in the state might be that it becomes non-viable for banks and other financial institutions to lend to small and marginal farmers of West Bengal as more than 90 per cent of farms here are small farms of the size of less than 2 hectares. The owners of these small farms depend largely on credit for meeting their working capital requirements and capital formation. The NABARD estimated that around 60 per cent of credit requirement is made by institutional sources in the state thereby making farmers widely dependent on informal finance. During 2006-07, the percentage share of West Bengal in
financial assistance provided by NABARD was 5.94 which had again been low compared to many other states.

In West Bengal, as a whole, there has been some improvement in the credit deposit ratio over the years. The C-D ratio for the state in 2005 was 65 but the C-D ratio in rural Bengal has remained only 28.4. It is also important to mention here that the C-D ratio for rural Bengal has declined from 43.2 in 1994 to 28.4 in 2005. The lower C-D ratio for rural areas of the state possibly indicates a shift of credit from rural to urban areas. Only about 28 per cent of the savings mobilized from rural areas of Bengal by the scheduled commercial banks is being lent out in the rural areas. The low availability of institutional finance has led to continued domination of informal sources of credit in the rural areas. In the countryside poor people are dependent on contractual arrangements of credit which are interlocked in nature. Although the dominance of moneylenders in the informal credit market has declined, there is an increase in the incidence of interlinked transactions between peasants and traders.

Inadequate institutional credit, along with other factors, is hindering technology adoption and as a result, large scale inter-regional and intra-regional disparity exist in the credit market. Disparity is rampant across developed or irrigated and underdeveloped or unirrigated regions. It also exists across size-classes in a particular region irrespective of its level of development.

The other worrying fact is that even after a large extent of commercialization, farming has remained unviable for many households. Net earning from farming is not adequate to meet the consumption needs of farmers. Besides this, farmers in many cases are deficit producers making them vulnerable to the whims of informal lenders in the absence of adequate formal finance with all its associated formalities.
This study attempts to analyse the issues related to accessibility of farm households to formal credit network and the prospects of informal finance with the help of tabular and statistical analyses. To understand the varying terms of borrowing and lending in the credit market for different categories of farmers depending on their collateral position and elasticity of demand, qualitative probe has also been made. It has been attempted to look into the composition of informal sources of finance and the issues of contractual arrangements in the interlinked markets. The study has examined the issue of transaction costs for formal finance, and credit gap i.e., the gap between requirement and availability of credit. It has also highlighted the possibility of incorporating the positive features of micro finance in improving the standard of living of the farm households. This aspect of micro finance has been examined with the help of a case study emphasizing on SHG-Bank linkage.

1.3. Objectives of the Study

The present study has been undertaken to identify the hindering factors for building and maintaining an efficient credit delivery system to sustain the growth performance in West Bengal, to find out the forces required to enhance the accessibility of marginal and small farms to institutional sources, the present study has been undertaken.

In order to get a real picture of the state of farmers in West Bengal in terms of accessibility of credit, a need has been felt to examine the credit scenario in the context of rural areas. It is worth mentioning that the development process has not been uniform all over the state, even large scale discrepancies prevail within the peripheries of a district. Hence an insight into the credit situation at the district level is necessary to complement the observation derived at the state level. Two districts having completely opposite infrastructural background and agricultural performance
level have been selected to compare and contrast the credit situation between a developed and irrigated region and an underdeveloped and unirrigated region.

The specific objectives of the study are:

1. To look into the access of small and marginal farmers to institutional and non-institutional sources of finance.
2. To analyse the reasons for inadequate access to formal finance e.g., cooperatives, commercial banks, regional rural banks, land development banks etc.
3. To find out the extent of inadequacy of access across different size of holdings i.e., to measure the credit gap for all farmers, in general and for small farmers, in particular.
4. To study the role of transaction costs in this inadequate access to formal finance.
5. To analyse the linkage between credit and product market and with other input markets both for the developed as well as underdeveloped regions under study.
6. To identify the channels for integrating the flexible and informal features of micro credit agencies in lending, recovery and repayment operations of formal institutions.

1.4. Hypotheses

The following hypotheses have been framed to study the objectives of the thesis as mentioned earlier:

1. Formal sources of finance are inadequate to meet the credit requirements of the poor farmers.
2. The amount of loan from the formal sources is related with the land-holding size, educational status, income from some other sources e.g., livestock etc. and overdues.
(3) The credit gap is more for small farmers than all farmers in terms of production and consumption credit.

(4) The transaction cost of borrowing is expected to be negatively associated with the farm size. This negative relationship is expected to hold good both in the credit markets of developed as well as underdeveloped regions.

(5) Transactions in dual or multiple markets involving credit, input and product markets, technically known as inter-linked transaction exist not only in the underdeveloped agrarian region but also in the developed agrarian regions where production is carried on under technologically advanced conditions.

(6) Positive features of informal sources of finance can be incorporated in formal financial agencies to improve the financial conditions of the households.

1.5. The Structure of the Thesis

A comparative analysis has been made of the developed and underdeveloped regions of West Bengal keeping in mind the general and specific objectives of the thesis. The whole study has been divided into eight chapters which have been designed as follows:

The present chapter deals with introduction, issues, and objectives of the study. This chapter also highlights the chapter scheme.

In chapter 2, credit scenario of the country and that of West Bengal have been depicted. The overall credit situation in the country with special reference to the period of reforms, credit disbursement by different agencies, regional disparities and credit supply to different categories of farmers have been discussed. The position of West Bengal vis-à-vis other states and India have been discussed with the help of secondary data.

---

1 Transaction cost may include member's registration charges, cost involved in getting farmers' inventory checked, borrowers' traveling cost for negotiating, acquiring and repaying the loans.
In chapter 3, the literature related to formal and informal credit has been reviewed. Findings of the authors in the context of India and that of West Bengal have been discussed. The limitations of the existing literature and the need for the present study have also been discussed in this chapter.

Chapter 4 mentions the profile of the study area, methodology, sampling design and data sources.

Chapter 5 deals with farmers' access to credit through analysis of primary data. The nature of participation of farmers in the credit market, terms and conditions in the credit market, determinants of accessibility to formal credit and the credit gap are discussed in this chapter.

The nature and terms and conditions of interlinked credit market prevalent in the developed and underdeveloped regions are discussed in Chapter 6.

Chapter 7 deals with different aspects of micro credit with special emphasis on SHG-BANK linkage programme.

In Chapter 8, conclusions, suggestions and policy implications of the study are discussed.