CHAPTER I

Aspects of Agricultural Credit

Provision of organised, adequate, timely and cheap credit is basic to the development of agriculture. Credit does play a pivotal role in agricultural progress. It is indispensable to an agriculturist to the same extent as to an industrialist. The savings of an agriculturist being meagre, he cannot depend upon his own resources. It has been rightly stated: "The farmers in the underdeveloped countries cannot expect their capital needs to come from savings, because their income from farm operations is barely sufficient to provide the minimum necessities of life, (food, clothing and shelter). Thus he has to depend upon outside finance.

The All India Rural Credit Survey Committee observed "Agricultural Credit is a problem when it cannot be obtained; it is also a problem when it can be had but in such a form that on the whole it does more harm than good. It may be said that, in India, it is this twofold problem of inadequacy and unsuitability, that is, perennially presented by agricultural

Finance is necessary for any economic activity connected with agriculture or manufacturing industry. It may be said to be the circulatory system of the economic body, making possible the needed co-operation between the many units of activity ...."Something must direct the flow of economic activity and facilitate its smooth operation. Finance is the agent that produces the result".

PLACE OF CAPITAL

Agricultural finance is concerned with the acquisition and management of capital in the farm business. Farming like other kinds of business requires capital, but it is not necessary that the farm operator has all the capital which the business requires. The amount of capital, he has, largely determines his position on the agricultural ladder. Without capital he must usually work as a hired labourer; some capital may enable him to be a tenant, and still, more a part-owner, a mortgaged owner, or a full-owner.

Capital is a must for any kind of business. Without capital nobody can expect to prosper in his business. It is necessary for farmers, just as it is necessary for entrepreneurs, to incur expenses, in producing goods in advance of

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3 Husband and Docker, Modern Corporation Finance, p. 8.

4 Ross, C. Robert, An Introduction to Agricultural Economics, p. 244.
receiving payment for the finished products. That is to say, farming requires capital.5

Farming in its simplest form requires land and some equipment, specially buildings and machinery. All these require to be invested in farming. Expenses are incurred before products are ready for sale, and these call for working capital.6

Agricultural credit includes a broad field: The principles of farm credit, the activities of lending agencies and the ways in which the farmers make use of credit. But our approach will be limited to the credit made available by different institutional lending agencies to the farmers of Assam for the period 1951-52 to 1973-74 for the development of agriculture in the State as well as benefits accrued to the farmers in their standard of living out of the credit.

FINANCING PROBLEMS

Financing agriculture is not a single problem, but consists of the combined problems of a large number of individual units. For each unit the financing problems are different, for the welfare of the farmer and his family depends not only on securing the right amount of capital, but also upon

5 Cohen, R. Economics of Agriculture, p. 62.
how well this capital is invested in a business of economic size and upon the degree of managerial ability with which the whole farm is operated. It is the combination of these elements which produces the income necessary to retire debts or to accumulate reserves. The amount of capital and the type of management would be expected to vary with different areas and different types of farming.  

Credit plays a significant role on production but farm credit is directly and more significantly related to the output. An increase or decrease in credit causes changes in output when other determinants are constant.

Return is a guideline in the use of credit. By returnability we mean an adequate yield and its corresponding investment. Farmers keep the goal of maximisation of net returns for the farm as a whole. In general, they are bound to be interested in total income produced rather than in maximising income for one particular crop or enterprise.

The returnability guideline is important not only for farmers, it holds good for other sectors of the economy as well. It is relevant to any business operation too.

In fact it guides a farmer to work out his range of investment preferences. If the Government makes it possible for every farmer to go ahead only in this norm, obviously the total

7 Ibid, p. 247.
agricultural yield of our country would maximise.\(^8\)

**TIME FACTOR**

All production processes take time before the inputs are converted into outputs. In crop production, this time lag is more than in manufacturing industries. This implies that expenditures on inputs have to be incurred much in advance of the income from resulting outputs. Producers meet these expenditures out of their past savings and whenever their savings fall short of the requirements they borrow. Hence crop loans are borrowings made to supplement the farmers' own cash savings in order to meet the expenses of growing crop to be repaid in the next period out of the income from these crops. Thus they are purely seasonal or short period loans. The amount of crop loan required can be taken as the difference between the working capital requirements during a crop season and the available owned funds in the same period, since the income flows of the farmers are seasonal, the owned part of the working capital will depend on the net income from the previous crop season. Hence the demand for credit in any one season will depend on the productivity and prices of inputs, prices of output and the net income from crops in the previous season.\(^9\)

As seen above, the interval between the initiation of production and incoming of receipts is long in agriculture and

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farmers have often to borrow to start and carry on the work of production. Thus credit is needed for the purchase of agricultural implements, such as, ploughs and livestock and for current expenses incurred on the payment of wages, the purchase of seed and fertilisers, the maintenance of farmer, and his family etc. This can be called production and equipment credit.

Credit is also needed to enable the farmer to wait for a better price and to enable him to sell in the most profitable market. This can be called 'Marketing Credit'. When no provision is made for the supply of such credit, the urgency of his need for cash compels the farmer to sell his crop as soon as the harvest is over, when the prices are extremely low.

These foregoing needs apart, the farmer often requires credit to purchase land and to effect permanent improvements. In India, farmers require credit to pay off their prior debts and to redeem their mortgaged land. Very often permanent improvements, such as, the draining of land, the construction of a well or the construction of farm buildings add to the income of the farmer and he has to borrow the capital necessary to effect improvements. This can be called Settlement and Development Credit.

Thus some credit is short-term credit, needed for short periods to meet current expenses and to facilitate production. Similarly medium-term credit is normally required for periods ranging from two to five years for the purchase of stock and
machinery, for small or occasional improvements and for the production of crops involving a long economic lag. In the same way long-term credit is needed normally for a period of five to thirty years for the purchase of land and standing improvements and for affecting permanent and durable improvements as, for instance, the construction of wells and embankments. Having regard to their income and obligatory expenditure, farmers can repay the loans raised for these purposes only out of the extra income secured by the investments, repayment has, therefore, to be in instalments spread over a number of years.

Credit is related to production and employment system of an economy. In India, where small farmers consist of more than 80 per cent of the total agricultural population, this question holds serious importance. It is obvious that we have sufficient number of disguisedly unemployed farmers and unless they are made really productive the chances of improving their economic conditions are very dim.¹⁰

Defining credit Prof. J.K. Galbraith observes: "It is the transfer of assets or wealth, or the right to acquire assets or wealth from a man who has to a man who has not. And this is done against a promise to repay the value of what was borrowed, and something more."¹¹


Credit in agriculture is necessary for accelerating agricultural development. The demand for farm credit can be defined as the amount of money required by the farmers to meet the costs of inputs and in modernising the equipment during a given period of time.

Given the socio-cultural set-up in a region, the demand for credit, is mainly originated from two major sets of variables, namely, economic and technological. The economic variables include the size of the operational holding, extent of irrigation, intensity of cropping, cropping pattern and the productivity per hectare. The technological variables include the use of oil engines, electric motors, tractors, fertilizers, pesticides, and High Yielding Variety of Seeds. However, the technological factors may sometimes overwhelm the economic factors in determining the demand for farm credit.\textsuperscript{12}

The monetary system of a country is the main factor which is responsible for the availability of credit.\textsuperscript{13} By monetary system we mean, in this context, total banking operation made by different institutional and private agencies. Therefore, Government policy plays an important role to determine the volume of credit to be released for agricultural development. In a country like ours where cultivators'...
financial position is very negligible, the Government has a honourous responsibility in formulating a national programme, considering the credit situation prevailing in the country. Specially in a country where private lending agencies are more effective, their systems are to be overhauled to provide a better results.

Cultivators' ignorance also affects the flow of credit. They are generally illiterate and do not possess the knowledge of official procedures and functions of getting loans.

Farm education amongst small farmers is almost absent and they are, consequently and severely handicapped. Farm education is not a private affair and in this regard whatever, the Agricultural Department is providing, is insufficient.

The ownership of a farm free from debt has long been held as an ideal by American farmers. So strong has been this ideal that farmers have often sacrificed greater income and taken undue risks in their attempt to attain it.

Another type of expenditure which is to be met in advance of the receipts for the products is the cost of living of the cultivator and his family. These expenditures must be incurred throughout process of farming.

14 Horme, E.A., Small Farmers' Crisis, 1959, p. 29.
15 Cohen, R.L., The Economics of Agriculture, p. 64.
PROBLEM OF AGRICULTURAL CREDIT

The farmers must themselves have resources to bridge the gap between expenditures and receipts or they must borrow from those who have. In general his own resources are limited and if he depends upon his own resources the scale of cultivation at which he can operate will be restricted according to his resources. It is, therefore, necessary to consider the extent to which he can borrow from others to operate his farming on the most economical scale. This is the problem of agricultural credit.16

ADEQUACY OF CREDIT

Credit is an essential aspect of farm operation. But in Assam it is shy and not adequately available. For its inadequate availability, unless some strong measures are taken immediately the agrarian condition will further become serious. Credit that is available in the market goes to the more powerful farm operator. Small farmers' share is maximum, because their potentiality in size is as big as 85 per cent and from the point of view of the maximisation of social welfare they deserve a significant portion of national income.

Since independence different agencies, in our country, have focusing the issue in their own ways, but no fruitful consequence has come out owing to the loose governmental system.

It has seriously affected food production during the last recent years. Since this cumulative problem is serious an immediate change in the entire credit system is an imperative need. The new system should be formulated in such a way that the weaker section of the farming community get adequate credit for smooth running of their cultivation.

The poor farmers need capital aid. And for that purpose such institution of credit should be organised and promoted which will not only mop-up rural savings but also channelise them in farm requirements.

There are limits to which different borrowers may seek loans, and to which the lenders may be willing to lend. For cultivators, the limits are determined by their resources and requirements. In the case of the lender the total liquid cash that he has is the limit to his lending. For secured loans, the amount and the nature of the security sets the limit, but for the unsecured loans, personal influences count.

The most neglected aspect of agricultural development has been the inadequacy of institutional credit. The institutional credit system was developed only for the organised industry and does not care for the peasantry, because cultivators are not considered credit-worthy. Hence it will be true to say that the Indian farmer is not credit-worthy because he is poor and he remains poor because he is not
Now what does adequacy mean? The requirements of cultivators are two-fold, namely:

i) Production credit to carry on their production activities and

ii) Consumption credit for their sustenance during the lean period. The need for consumption finance comes from the fact that their consumption requirements always tend to run ahead of their production schedule and must be met from outside.

Adequacy, therefore, means that apart from meeting the production and consumption needs of farmer there must be surplus for additional investment, so that the farmer can repay his loan and ensure a better standard of living.

The actual consumption credit to be given to a farmer must have relation to his minimum needs and his capacity to repay. In cases where a farmer requires consumption credit but has no capacity to repay it was a problem to be tackled by social reforms and charity structures.

COST OF LOAN

Reasonable cost is one mark of a good loan. The cost involves not only the stipulated interest rate but also other fees for applications, appraisals, commissions, attorney and
abstract service. Lenders differ in extra fees assessed upon the borrower.\textsuperscript{18}

Cost of loan increases if the borrower has to come for several times to the offices from where loan is given. The borrower is to spend extra money by way of conveyance expenses which is also to be included in the cost of loan.

Interest is the principal cost of loan. Classically, the rate of interest was thought to be the main determinant of investment. Theoretically the farmer should invest in a durable input if the rate of return on that investment is greater than the rate of interest. The rate of return on capital in agriculture varies widely because of exogeneous factors, such as, weather. The interest rate is likely to be important in explaining investment if it represents the availability of funds. Evidence does suggest that an inverse co-relation exists between aggregate investment and investment in agriculture. An increase in the supply of funds to potential borrowers is associated with a decrease in the rate of interest. Therefore, when the interest rate falls, investment is likely to rise both because it becomes cheaper to borrow funds and because the supply of these funds increase.\textsuperscript{19}

The purpose and use of loan is of significance, if the purpose is unproductive or wasteful the rate of interest is

\textsuperscript{18} Ross, Robert C., Agricultural Economics, p. 252.
\textsuperscript{19} Metcalf David, The Economics of Agriculture, pp. 52-3.
high. Interest which is a payment for the use of credit, reflects the demand for and supply of credit. A rural credit system raises the rate of interest and also increases the value of the farm credit. With a higher rate of interest, the utilisation of capital is restricted much. The unproductive needs of the peasants are often regarded as urgent and inelastic by him, hence the high rate of interest.

Credit is interest elastic. The demand for credit declines with the increase in the rate of interest. The average elasticity of demand for credit with respect to interest rate indicates that the demand is inelastic. The magnitude of elasticity increases with the increase in the rate of interest.

Generally, the demand for credit by the marginal farmers is inelastic with respect to the rate of interest and highly elastic with respect to prices of both input and output prices, the demand potential for credit by the marginal farmers is likely to be very much higher. 20 This is because the relation between input and output prices, determining as it does the profitability of agricultural operations, has

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tremendous influence on the quantity of inputs used and on credit requirements.

Interest rates vary also with the purpose of the loan, the degree of risk, and the lending agency. Short-term credit institutions is cheaper than that from merchants, though the credit cost of the later may be concealed in the price of the product. Loans of small size necessarily involve high overhead costs. If interest is deducted in advance, the real cost is higher than if it is paid at maturity. This procedure is most prevalent in Assam where "Mahajanas" and "Kabulis" deduct their interest in advance ranging between 20 to 25 per cent thereby making actual payment of $80 to 75 per hundred Rupees. On budgeted loans interest charges may be based upon the amount of the loan outstanding or on the entire credit account for the full contract period. On real estate loans both the rate of interest and the length of the loan affect the interest cost. 21

The borrower should look for service, that is prompt, courteous, and businesslike and based upon an understanding of his needs. This service can be used to better advantage if the office where loans and contracts are made is within a convenient distance.

The cost of loan becomes high due to high rate of interest charged for agricultural credit. It not only hurts agricultural

21 Ross, Robert C., Agricultural Economics, p. 252.
credit but also affect production and thereby create shortages in the economy. Apart from high rate of interest charged on agricultural finance there are other charges which constitute a part of the cost of credit to agriculture.