3.1 Need for Agricultural Credit:

Agriculture in India has always been a way of life rather than a business and has suffered from stagnation due to low productivity arising from inadequate investment. Low investment is caused by low farm income which follows in turn from low resources productivity completing the vicious circle. The crucial problem, therefore, is to break-through this vicious circle somewhere and somehow. The only way to bring about an upward movement is to find ways of increasing capital investment. An initial push, which has been characterised as “Big-push” by Rodenstein-Roden, “critical minimum effort” by Leibenstein, “Bottle-neck breaking” by Ragnar Nurkse, “Linkage effects” by Hirschman, all convey in one way or the other a need for giving greater attention to capital investment to break the vicious circle.

To meet the growing needs of millions, the traditional agriculture has undergone tremendous changes to increase food production. The emergence of green revolution in India by the late sixties has radically changed the character of Indian agriculture. Agricultural development presupposes technological transformation from traditional to modern technology (AFC, 1970). There is a growing tendency among the farmers to replace the traditional farming practices with scientific and modern practices, which is reflected by the use of HYV seeds, fertilizers, pesticides, irrigation, machinery and equipment etc.. These inputs require heavy financial investment, which the majority of farmers cannot afford from their own savings. Food and Agriculture Organisation (FAO) has rightly stated that, “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” (FAO, 1955). The farmers, therefore, have to depend to a large extent on borrowed funds. This has naturally increased the demand for providing credit to a large number of farmers.

Development of agriculture can take place only if farmers move from traditional to modern agriculture. This transformation calls for provision of substantial credit for agriculture, besides a large variety of inputs and services. Modern agriculture requires considerable investment both of a recurring and non-recurring nature (George,
In the traditional phase of agricultural development credit merely plays a static role. Because of low productivity in agriculture and consequent low income, credit merely bridges the gap between income and expenditure. But credit plays a dynamic role and becomes catalyst for development in the process of transformation of agriculture from traditional stage to a higher technological plane (RBI, 1977). Increased demand for credit leads to increased application of productive inputs and consequent upon the change in input structure, higher productivity, higher income, follow credit plays a pivotal role in fostering economic development (Benerjee, 1977).

Agriculture being the oldest industry needs finance to fulfill its commitment to the society. Credit plays an important role in stepping up and stabilising agricultural growth in a country especially when it is associated with improved production technology (Dhawan and Kahlon, 1978). In general, the farmers spend on consumption and production inputs throughout the year, but they get returns from agriculture at one or few concentrated periods of harvest. Here the problem of credit arises. This necessitates either a saving process from the past income or borrowing (Lele, 1974). One of the most important lessons of universal agrarian history is that the agriculturists must borrow due to the fact that his capital is locked up in his lands and stocks. The demand for agricultural credit arises due to:

- the time lag between the realisation of income and operation of expenditure;
- unevenness of investment in fixed capital formation;
- increasing movements in capital needs and saving that accompany technological innovations;
- the seasonal character of agricultural production, which is superimposed on a largely perpetual and steady pattern of continuous consumption;
- cyclical, seasonal and annual fluctuations are more marked in agriculture than in any other industry;
- difficulty in accurately forecasting the farm-incomes but farmer’s income may fluctuate widely, creating gaps in his demands for funds and income expected form the farm; and
- estimates of input-output relations are beset with a number of difficulties and problems.

In agriculture there is a time gap between the investment and return. The gestation period of crops varies from months to years. To meet all the continuous
expenses till the gestation period, credit is essential. As the entire finance, needed by the poor farmer, cannot be procured by him, the need for credit is well justified. It becomes more imperative, when agriculture takes the shape of industry and moves on the road of commerce. No industry of the world, however, big or small, has ever made any industrial effort fully financed by own resources. Credit is inevitable need of commerce and industry. Then the very idea of growing crops for sale as well as for family consumption brought the question of use of credit. Uncertainties and crop failure are very common in Indian agriculture due to over dependence on monsoon irrigation. Enormous risk in the form of drought, flood, cyclone, pest attack and low prices of product etc., have encircled Indian agriculture. The loss faced in one year, needed to be financed from outside agencies, to continue the farmer’s occupation. Indian agriculturists have debt as an ancestral property and it is passed from generation to generation. To liquidate the old debt, finance is needed to the farmers who are indebted to the moneylenders; otherwise all possibilities are there for the transfer of lands from farmers to moneylenders. To retain the land in the hands of agriculturists, credit is to be made available to them. Credit may also be the result of ignorance, improvidence, recklessness, misgovernment, social customs, social evils and defective laws. In addition to borrowings for agricultural purposes, farmers frequently need credit for their personal consumption expenses. In particular, the low income of a large number of small farmers forces them to borrow for sustenance and such consumption credit forms an important part of the economy of farmers in our country.

Modernisation of agriculture involves an extensive use of modern technology and inputs which involve heavy investments. Various studies of sixties and seventies show that small farmers lagged in adoption of high yielding variety (HYV) technology due to inadequate flow of institutional credit besides uncertainty and unfavorable trenurial conditions (Muthaih 1972⁸; Schulter and Parikh 1974⁹; Parthasarathy and Prasad, 1978¹⁰). Another study conducted by NCAER (1974)¹¹ shows that the amount borrowed by technology adopters was far more than the non-adopters and farmers with access to irrigation facilities borrowed more than the farmers without access to irrigation facilities. The same study also shows that 81 percent HYV-adopter households financed through direct government loans and 62 percent of such households financed through co-operative societies loans.
Under the impact of new developments in agriculture science and technology, and increasing commercialisation of farming, agriculture is becoming costlier for cultivators. Over the years, prices of fertilizers, seeds, diesel and inputs have gone up. The 59th round of NSSO on the status of Indian farmers presents a sorry picture. Indian agriculture has undergone structural changes in recent times. The nature of Indian agriculture has geared towards small farms. There is marginalisation of Indian agriculture; too many small cultivators were cultivating a small proportion of land and few large cultivators were cultivating large tracks of land. This meagre base of Indian agriculture is vulnerable. Indian agriculture has also undergone changes in its output mix and thereby input mix. These changes were reflected by the shift in area from foodgrains to non-foodgrains, and within foodgrains from coarse cereals to finer cereals. The shift towards non-foodgrains has been observed across states with the exception of Bihar, Haryana, Jammu & Kashmir, Karnataka, Punjab, Uttaranchal, Uttar Pradesh and West Bengal. The maximum shift away from foodgrain crops was visible in Kerala followed by Jharkhand, Gujarat, Orissa and Assam. Oilseeds, cotton, tobacco and sugarcane have gained at the expense of cereals in terms of area. These crops have strong links with the market. The credit requirement also goes up with these changes. Changes in cropping pattern towards such crops influence change in input structure. The relative prices of inputs too have changed over time. Inputs like fertilisers, insecticides, mechanical power and improved seeds were vital parts of the input structure. They have replaced organic manure (though getting back into reckoning), animal power and farm-retained seeds. Farmers spend sizeable part of their resources on purchase of inputs. Hence, farmers have to take option of credit to a much larger extent than in the past for purchase of inputs. The credit requirement is highly related with the expenditure pattern of the farmers. They generally spent 32 percent of the borrowings on capital expenditure and 13 percent on current expenditure on the farm. But, other 47 percent mostly consumed by them on family expenditure and the rest 8 percent in other non-farm expenditures. This drowns the poor Indian farmers in indebtedness and so they require more and more credit to go for agriculture production. (Mohanty, 2007)\textsuperscript{12}. Thus, credit needs of farmers can be broadly divided into two parts: – productive and unproductive expenses. The productive requirements include, purchase of seeds, fertilizers and insecticides, improvement on land by irrigation and drainage, purchase of livestock, implements and raw materials, etc. The
unproductive requirements include expenses for marriage, death, serious illness and other social events in the family. Accordingly credit may not necessarily be a sign of weakness. None-the-less borrowing may be abused and indebtedness may be a symptom and a cause of danger.

3.2 Classification of Agricultural Credit:

Agricultural credit mainly consists of two types, viz., (a) direct, and (b) indirect. In direct financing credit is provided directly to the farmers for productive purposes, but in indirect financing, credit is not given directly to the farmers, but to the institutions engaged in the supply of production inputs and other services to agriculturists. Crop production credit; land improvement; irrigation improvement; purchase of implements; machinery and equipment; development of dairy, poultry, sheep-rearing, etc; development of plantations like tea, coffee, rubber, coconut, cashew nut, etc. are the examples of direct financing. On the other hand financing for distribution of farm inputs; financing Primary Agricultural Co-operatives/Farmers Service Societies/Co-operative Marketing Societies; financing State Electricity Board for energisation of pump sets; financing for storage facilities (warehouses and cold storages); financing for establishment of Regulated Markets, Custom Service Units; financing for Agro-industries Corporation, Food Corporation of India, Jute Corporation of India etc. are examples of indirect financing.

Agricultural credit can also be classified according to (a) period-wise, (b) purpose wise, (c) security wise (d) creditor-wise (e) debtor-wise. As every type of credit is having a character of another type of credit, so it is very difficult to segregate the credit from any isolated school. Every type of credit is interlinked and inter-related with each other. The period of credit is the general basis of classification, and the other groups may be regarded as sub-classification.

**Period-wise:** According to the period or duration, credit may fall into three categories, viz. (i) short-term, (ii) medium term and (iii) long term. The Rural Credit Survey Committee (RBI, 1951)\textsuperscript{13} has observed that short term or seasonal credit is one which provides the farmers the working capital to carry on agricultural operations efficiently, to obtain the best possible crop and to hold the credit until the harvest is sold. Short-term credits are granted for periods ranging from 6 to 18 months and are primarily meant to meet seasonal requirements such as, seeds, fertilizers, insecticides, hiring of
labour etc. such credits are expected to be repaid at the time of harvest. These are also known as crop loans. The period of medium-term credit generally ranges from 2 to 5 years and they are for purposes such as, land improvements, purchase of implements, machinery, livestock, etc. They have to be repaid by half yearly or annual installments. These are also known as term credit or investment credit. Long-term credits are generally granted for periods longer than 5 years and extending upto 10 years or in some cases 20 years. Such credits are granted for making permanent improvements on land like, drainage, sinking of wells, construction of farm houses and store houses, cattle shed, purchase of land and repayments of old debts etc. These loans have to be repaid by annual installments. There is no vast difference between medium term and long-term credit as they can be required even for the same purpose but depends upon the size of farms and their repayment potential.

**Purpose-wise:** RBI in its Rural Credit Follow-up Survey, General Report (1959-60) has classified agricultural credit on the basis of purpose, which is of three types, viz. (i) credit for farm business, (ii) credit for non-farm business, and (iii) credit for family expenditure. Credit for farm business is provided for the purpose of purchase of seeds, fertilizers, insecticides, hiring of labour, land improvement by irrigation and drainage, purchase of agricultural implements, machinery and livestock, construction of farm house, cattle shed, tanks and embankments, laying of orchards, etc. i.e., to meet the working and capital expenses on farm business. Credit for non-farm business is supplied for the purpose of repair of production and transport equipment, construction and repair of buildings, furniture purchase, etc., i.e., to meet the working and capital expenses of non-farm business. Credit for family expenditure is required for the purpose of meeting the house-hold expenditures such as, clothing, education, medicine, expenses relating to marriage, death, ceremonies and other social events in the family, litigation, payment of old debts, etc.

**Security-wise:** Agricultural credit may be classified as secured or unsecured i.e., of two types. The lending agencies are generally found to be keen to have adequate and satisfactory security against the loans advanced by them, to fully cover the risk involved in granting loans to the farmers. On the basis of security, the credit is classified into three types, viz., (i) real or mortgaged credit, (ii) chattel and collateral credit, and (iii) personal credit. Real or mortgaged credit is secured against mortgage of land or any other immovable property. Chattel and collateral credit is obtained
against some tangible property of the borrower like, farmer’s livestock, warehouse receipts, shares, bonds, insurance policy, etc. Personal credit is generally based on the character and repaying capacity of the borrower. It is advanced on the promissory or personal notes of the borrower and sometimes by the guarantee of a third party who can stand surety for the borrowers. This is unsecured type of credit.

**Creditor-wise:** Creditor-wise or lender classification is done on the basis of sources of credit. There are mainly two sources of credit, viz., (i) non-institutional sources, and (ii) institutional sources. Non-institutional sources include moneylenders, commission agents, indigenous bankers, landlords and others including relatives and friends. This type of credit is not governed by any code of conduct and has been generally found exploitative. Institutional sources, include, commercial banks, co-operatives, regional rural banks and governments. This type is governed by proper codes of conduct and is intended to be conducive to development.

**Debtor-wise:** Debtor-wise classification of credit is based upon the major source of income received by the borrower, such as crop farmers, dairy farmers, fishermen etc..

### 3.3 Sources of Agricultural Credit:

**(A) Institutional Sources:**

The agricultural credit system as developed and evolved over the years through reforms and policy initiatives are characterised by dualistic structures, limited availability of collateral, covariant risks and seasonal fluctuations in the supply and demand for financial services as well as high transaction costs. Thus, there are three streams of credit operating in the rural areas:

(a) Co-operative banks,

(b) Commercial banks (CBs), and

(c) Regional rural banks (RRBs).

Each of these three streams has its own distinctive organisational features but common in all of them have a structural pattern which provides a machinery for dispensing credit at village level, whereas the organisation of higher levels is by and large federal in case of co-operative banks, it is unitary in case of RRBs and commercial banks. All the three streams are linked, either through the state apex organisations in case of co-operative banks or through the head office in case of RRBs
and commercial banks, to the NABARD for withdrawal of resources to supplement their own. The national level apexes are directly linked in varying degrees, to both the Government of India in respect of broad framework of policy objectives and most of them are linked to the Reserve Bank of India in respect of policy, funding and operational control. The structural pattern of the various sectors in the rural credit system from the base level to the national level is illustrated in the Figure-1.

**Figure-1: Institutional Framework for Agricultural Credit in India**

Source: Based on RBI Report of the Committee to Review Arrangement for Institutional Credit for Agriculture and Rural Development (CRAFICARD) 1981.
The existing institutional set-up for providing agricultural credit in India is as follows. Agencies operating at the national level for providing refinance to other agencies are RBI, National Co-operative Development Corporation (NCDC), National Bank for Agriculture and Rural Development (NABARD), and Agricultural Finance Corporation (AFC). At the state level, the State Co-operative Agriculture and Rural Development Banks (SCARDBs), State Co-operative Banks (StCBs), and Commercial Banks (CBs) constitute the source of rural credit. At the district level District Central Co-operative Banks (DCCBs) and Regional Rural Banks (RRBs), are the agencies purveying credit and at the field level Primary Co-operative Agriculture and Rural Development Banks (PCARDBs), branches of RRBs, rural branches of CBs, Primary Agricultural Credit Societies (PACs), Large Area Multi-purpose Societies (LAMPS) and Farmers Service Societies (FSS) are providing credit to the rural borrowers.

Table-1: Institutional Framework for Agricultural Credit in India

<table>
<thead>
<tr>
<th>Level</th>
<th>Number</th>
<th>Name of Institution</th>
<th>Functions</th>
</tr>
</thead>
<tbody>
<tr>
<td>National</td>
<td>4</td>
<td>1) Reserve Bank of India</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) National Co-operative Development Corporation (NCDC)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3) National Bank for Agriculture and Rural Development (NABARD)</td>
<td>Refinance, Consultancy and monitoring</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4) Agricultural Finance Corporation (AFC)</td>
<td>Refinance, Consultancy, Technical appraisal</td>
</tr>
<tr>
<td>State</td>
<td>3</td>
<td>1) State Co-operative Agriculture and Rural Development Banks (SCARDBs)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) State Co-operative Banks (StCBs)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3) Commercial Banks (CBs)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td>Districts</td>
<td>2</td>
<td>1) Regional Rural Banks (RRBs)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) District Central Co-operative Banks (DCCBs)</td>
<td>Refinance &amp; Consultancy</td>
</tr>
<tr>
<td>Field</td>
<td>4</td>
<td>1) Primary Co-operative Agriculture and Rural Development Banks (PCARDBs)</td>
<td>Financing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2) Rural Branches of Commercial Banks</td>
<td>Financing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>3) Branches of Regional Rural Banks (RRBs)</td>
<td>Financing</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4) Primary Agricultural Credit Societies (PACs)</td>
<td>Financing</td>
</tr>
</tbody>
</table>

Source: Figure-1.
(I) Co-operative Credit Institutions:

Rural credit co-operatives in India were originally envisaged as a mechanism for pooling the resources of people with small means and providing them with access to different financial services. It has very important role to play in the Indian financial system and especially in the sphere of rural finance, both for agriculture and small-scale and cottage industries. In spite of concentrated efforts being made to open branches of nationalised commercial banks since 1969 in rural areas, it may still be the most satisfactory institution for providing finance to borrowers in rural areas of India. As the Punjab Banking Committee Report pointed out, “A scheme of Government or Joint Stock Finance might reduce the rates of interest, but only cooperation can teach the peasant to borrow at the right time, and in the right amounts and for right ends, and to repay on right dates, and, only cooperation can teach him to serve so that he may not have to borrow at all” (Desai, 1979). Co-operative credit institution is supposed to be “an association of borrowers and non-borrowers, who, residing in a locality, know one another and take interest in one another's affairs”. Membership of the society is open to any person in the locality, provided fellow-members approve the membership. While admitting a new person, his character (regardless, of caste and creed) is taken into account (Ibid.)

Co-operative credit institutions have emerged as a ray of hope and vehicle of rural finance for economic development. Till the nationalisation of 14 commercial banks in 1969, the organised sector that stood to provide rural credit was the co-operative credit network only. The major beneficiary of co-operative banking is the agricultural sector in particular and the rural sector in general (Gupta, 1982).

(i) Organisation and Functions of Co-operative Credit Institutions in India:

The co-operative credit institutions are one of the most extensively distributed institutions in India as they have been set up at the grass root level in every nook and corner of the country. The co-operative banking structure in India comprises of agriculture and non-agricultural credit institutions.

Rural co-operative credit institutions operate mainly for the benefit of rural areas in general and agricultural sector in particular. The rural co-operative credit institutions can be bifurcated into two parallel wings supplying short-term and long term credit. The short term rural co-operative credit institutions have a federal three tier structure consisting of:

1. State Co-operative Bank (StCB) at the apex (state) level,
(2) District Central Co-operative Banks (DCCBs) at the intermediate district level, followed by
(3) Primary Agricultural Credit Societies (PACS) at the lowest (village) level.

The Long-term credit structure is made up of:
(1) Primary Land Mortgage Banks, at the base, and
(2) Central Co-operative Land Mortgage Banks, at the apex.

These are the generic names, now these are known as Primary Co-operative Agricultural and Rural Development Banks (PCARDBs) at the base level and State Co-operative Agricultural and Rural Development Banks (SCARDBs) at the apex level.

**Figure-2: Co-operative Credit Institutions**

The organisation of rural credit shows a great deal of variation in the country. At present, 15 states have three-tiered and in 12 states/union territoriess have two-tiered short-term credit structures. The North-Eastern region has mostly unitary
structure with state co-operative bank providing credit directly to PACS instead of any district level intermediary. As far as long-term credit structures are concerned, 10 states had a federal structure, while two states namely West Bengal and Himachal Pradesh had a mixed structure of long term co-operative credit, along with 8 states had a unitary structure in 2008. These institutions differ from state to state. By the end of March 2010, there are 31 StCBs; 370 District Central Co-operative Banks and 95,633 PACS. The number of SCARDBs is placed at 20 while the number of PCARDBs is placed at 697 (RBI, 2010).^17^

(a) **State Co-operative Bank:** Being the highest agency of the three-tier co-operative credit institution in each state, it serves as a link between RBI and District Central Co-operative Banks (DCCBs) and PACS, vested with the responsibility of providing credit support to agriculture and allied activities through a network of DCCBs and other state level co-operative organisations and government corporations. National Agriculture Bank for Rural Development (NABARD) provides credit to lower level co-operatives through the state co-operative banks. StCBs are also entitled to undertake banking business under the provisions of Banking Regulation Act. As apex bodies, the StCBs exercise control and provide guidance to the co-operative network in the respective states. The StCBs exercise control and supervision over DCCBs and PACS. For financing the affiliated banks and societies, the StCBs derive resources from owned funds, reserves, borrowings and deposits. More than half of their working resources are through deposits from the lower rung banks like DCCBs and PACS.

(b) **District Central Co-operative Banks:** The DCCBs constitute the middle-tier of the co-operative credit institution. DCCBs act as a link between the state co-operative banks (StCBs) and primary agricultural credit societies (PACS) under three-tier structure. Their main function is mobilisation of deposits from the members and non-members and provision of adequate credit to the lower tier credit institutions like PACS. It is also expected to act as a guide, philosopher and leader of the co-operative movement in the district. To feed the co-operative credit structure the DCCBs should have a strong resource base. The resource base or working capital of DCCBs consists of owned funds, reserves, deposits, borrowings, etc. They are not allowed to have horizontal cash flows, that is, DCCBs are not allowed to borrow or lend among
themselves. Instead, they are required to deposit their surpluses if any with the concerned StCBs, which in turn lend to DCCBs depending upon their necessity.

(c) **Primary Agricultural Credit Societies:** The PACS occupy a predominant position in the co-operative credit structure. The edifice of the co-operative credit structure has been built on the foundations of PACS. These banks constitute the base and vast network of credit institutions at the village level. They link the total credit structure with the needy artisan or agriculturist. It deals directly with the agricultural borrowers, provide them with the loans and collects repayments of loan given. It serves as the final link between the ultimate borrowers and the higher financing agencies such as StCB, RBI and NABARD. The operating capital of the PACS is derived from owned funds, deposits, borrowings and other miscellaneous sources. Borrowing constitutes a major source of the working fund in PACS. Their members have unlimited liabilities and they contribute their share capital. The PACS accept deposits from both the members and non-members but only the members are entitled to borrow from them. Most of the loans are for agricultural purposes and are of short-term nature. The success of the co-operative credit movements depends crucially upon health and strength of these societies.

Attached to the organisation of the co-operative credit institutions, there are two refinancing agencies in the country at the national level; the RBI, which is, the Central Bank of the country providing through its agricultural credit department, refinance to the State Co-operative Bank for both short-term and medium-term agricultural credit, and the Agricultural Refinance and Development Corporation (ARDC), renamed as NABARD, a statutory body that provides finance by way of long-term development loans, mainly to State Co-operative Agricultural and Rural Development Banks (SCARDBs).

(ii) **Limitations of Co-operative Credit Institutions:**

Despite rapid growth the overall progress of co-operative movement during 107 years of its existence is not very impressive. It is therefore essential to know the causes of poor performance of the movement.

(a) **Government Interference** - The co-operative movement in India was initiated in 1904 under the auspices of British government. Right from the beginning the government has adopted an attitude of patronising the movement. Co-operative
institutions were treated as if these were part and parcel of the administrative set up of the government. The government interference thus became an essential element in the working of these institutions. As a result people’s enthusiasm for the movement did not grow.

(b) **Restricted Coverage** - The co-operative movement has also suffered on account of two important limitations on its working. The size of these societies has been very small and most of the societies have been single purpose societies. For this reason these societies are unable to take a total view of the persons seeking help, nor can they analyse and solve problems from different angles. Under these circumstances it has not been possible for these societies to make much progress.

(c) **Lack of Awareness** - People are not well informed about the objectives of the movement, the contributions it can make in rebuilding the society and the rules and regulations of co-operative institutions. Unfortunately, no special efforts have been made in this direction. People look upon these institutions as means for obtaining facilities and concessions from the government.

(d) **Functional Weakness** - The co-operative movement has suffered from inadequacy of trained personnel right from its inception. Lack of trained personnel has been caused by lack of institutions for the purpose of training personnel.

(e) **Lack of Self-sufficiency** - The production credit requirement potential of the country is always estimated as high and the co-operatives are expected to provide about 50 per cent of the agricultural credit needs of the country by the planners. However, the co-operative banks are unable to do so because one of the weaknesses of the co-operatives lies in their inability to mobilise deposits in the rural areas. Thus, the co-operative banks in the country are lacking much self-sufficiency with a continued dependency on the Central Bank of the country. Despite the efforts in the direction of strengthening the co-operative credit structure, a large number of institutions at the intermediate and base level. viz., the Central Co-operative Banks and the Primary Agricultural Credit Societies have remained financially and administratively weak and consequently unable to provide the needed credit to the farmers (Hate, 1997)\(^1\).

(f) **Non-viability** - The non-viability of co-operative banks is more alarming especially because it puts at stake the very existence of the bank in the long run. As observed by M.V. Hate, only 60 per cent of the primary agricultural credit societies are working
viably. Moreover, on the lines of the Japanese experience; non-viable units are either amalgamated with reorganised societies or liquidated. As strong and operationally viable primaries are the indicators of a sound and healthy credit movement and being the grass root level organisations, their strength has a direct bearing on the higher financing agencies (Seldavri, 1987)\textsuperscript{19}.

(g) Problem of Overdues - One of the problems in co-operative financing in India has been that of maintaining overdues. The high overdues have affected the overall financial health of the rural credit structure (Anand, 1994)\textsuperscript{20}. The amounts defaulted by the borrowers have acted as a serious restraint on the smooth flow of agricultural credit and constitutes a major obstacle in meeting the credit needs. The problem of overdue appears to be more serious with respect to PACS. The profitability of the co-operatives has been a matter of considerable concern. Unsatisfactory recovery of dues, low margins and nonviable nature of many PACS are important factors affecting the working of PACS (Patel, 1994)\textsuperscript{21}.

Apart from the major limitations explained above, the other important deficiencies of co-operative banks are absence of dynamism and functional diversification, failure to reorient the operational policies of co-operative banks in a more perpetual direction and lack of proper coordination among different levels of the co-operative credit structure. In view of these inherent limitations of the co-operative credit system, the RBI has been making efforts to strengthen tile co-operative credit structure and to ensure coordination and reorientation. The Committee on All India Rural Credit Survey expressed the view “cooperation has failed, but cooperation must succeed”. That is why every commission or committee that has examined the working and role of co-operative banking system in India has held the common view that cooperation remains the best hope of rural India, even though it has not been very successful till now.

(II) Commercial Banks:

Co-operatives were considered to be the most suitable agencies for financing agriculture till 1950s. The commercial banks with their inadequate rural coverage and urban orientation were not considered suitable for this task. The co-operatives were, no doubt, in the field but the extent of financial support extended by them was limited in relation to the magnitude of financing. The involvement of commercial banks catered
primarily to the needs of the commercial and industrial sectors, their share in institutional credit to farmers being almost negligible. However, it was realised later that co-operatives alone could not shoulder the complete responsibility of financing agriculture and rural development in view of increasing demands of these two sectors. Hence, a vital role had to be assigned to the commercial banks in the field of agriculture (Patodia, 1982). A change came rather drastically in the context of the Green Revolution, which underlined the importance of strengthening the institutional machinery for agricultural credit to facilitate technological development and modernisation of farming techniques. The increased credit requirements of the agriculture sector could not be met by co-operatives and government agencies alone and therefore, the commercial banks with their strong financial and organisational base, had to be actively involved. The commercial banks help the agriculture sector in a number of ways. They open a network of branches in rural areas to provide agricultural credit. They also finance agriculture sector for modernisation and mechanisation of farms, for the marketing of their produce, for providing irrigation facilities, for high yielding seeds and fertilizers. They provide medium or long-term finance for the purchase of tractors and other equipments, for electrification and installation of electric or diesel pump sets, or for developing or improving land etc. The commercial banks are moving fast towards the attainment of agricultural development goals (Shah, 1968). They also provide financial assistance for animal husbandry, dairy farming cheap breeding, poultry farming and horticulture. In India for financing agriculture various schemes have been undertaken (Saraiya, 1972). Since commercial banks are the single most important source of institutional credit in India they fulfill the credit requirements of all types of rural people and help in enlistment of rural areas.

(i) Organisation and Functions of Commercial Banks in India:

As stated earlier, the commercial banks involvement in rural credit in general and agricultural credit in particular, has increased with the nationalisation of major commercial banks in the country. Government of India (GOI) increasingly involved commercial banks in the country in rural finance and nationalised 14 major commercial banks in 1969, followed by 6 more in 1980 with directions to extend the flow of credit to hitherto neglected sectors
like agriculture and other rural development activities. Commercial banks have experimented with a number of alternatives and combinations of methods and approaches in different parts of the country with varying degree of success. These include building up of a base of technically qualified field officers, lead bank scheme (LBS), service area approach (SAA), group financing, financing through primary agricultural co-operative societies (PACS) and farmer service societies (FSS) etc..

Commercial banks extend credit to farmers for agricultural purposes in two ways, viz., direct and indirect:

- Under direct finance, the commercial banks extend short-term, medium-term and long-term credit to agriculturists for raising crops, purchase of agricultural implements and machinery, development of land, construction of farm, buildings and structures, construction and running of storage facilities, etc..

- The indirect finance to agriculture by commercial banks mainly includes; a) Credit for financing the distribution of fertilizers, pesticides, etc. b) Loans to electricity boards, and, c) Loans to farmers through PACS, FSS and LAMPS. Finance for hire purchase schemes for distribution of agricultural machinery and implement, loans for construction and running of storage facilities, advances to custom units, loans to co-operative marketing societies, etc. also come under the category of indirect finance to agriculture by commercial banks.

(ii) Limitations of Commercial Banks:

(a) Organisational Problems - This involves (i) the paucity of trained staff who is well conversant with the local language and the local traditions and customs of the people to tackle problems immediately. (ii) lack of suitable accommodation, delay in preparing suitable and simplified forms, lack of making provision for security of funds, (iii) the over-lapping of operational areas (both geographically and functionally), double or multiple financing, unhealthy competition among competing financial institutions, concentration by these institution on agricultural prosperous areas and on big and well-to-do agriculturists in such areas, comparative neglect by these institutions of agriculturally backward areas and of small and marginal farmers in
general. These difficulties have affected the efficient working of the commercial banks.

(b) Legal and Administrative Problems - These have often impeded the smooth flow of funds from the commercial banks to the agricultural sector. Such problems are usually concerned with; (i) incomplete land records particularly in zamindari areas, (ii) lack of facility for non-transferability of land, (iii) extremely cumbersome and time-consuming process for creating mortgages which lead to exploitation of the illiterate borrowers, and, (iv) a heavy stamp duty, which places a great burden especially on small and marginal borrowers.

(c) Procedural Problem - These problems relate to complexity of application forms and documents to be executed by agricultural borrowers.

(d) High Cost of Credit - Since poor cultivators often fail to make regular payment of their dues owing to wide fluctuations in prices of agricultural commodities, the cost of providing agricultural credit is pushed up. The other administrative costs are also high. This is particularly so because the number of customers per branch of a commercial bank in rural areas is comparatively small.

(e) Social and Political Problems - The small cultivators are still in the clutches of agricultural moneylenders and therefore, they have a control over them. This prevents the cultivators from approaching the commercial banks. Furthermore, in the rural areas political factionalism is rampant, which compel the banks to provide finance to particular group of farmers and also to provide moratorium on loans given.

(f) Problems of Overdues and Recovery of Loans - Commercial banks have a great problem of non-recovery of loans, which may be due to (i) willful default on the part of certain agriculturists, (ii) defective appraisal of loan applications of agriculturists in terms of assumptions made regarding prospective yield, input, costs and output prices, (iii) unsatisfactory marketing arrangements (in terms of availability of marketing yards, cold storage, go-downs, etc.) resulting in agricultural borrowers getting lower than expected prices for their produce, (iv) natural calamities like floods, droughts and epidemics resulting in death of cattle, and (v) lack of earnest efforts on the part of the bank staff to recover loans by undertaking efforts and trouble.

(g) Increasing Burden of the Staff - With the expansion of branches and diversification of business, the number of bank employees has rapidly increased.
Besides, the staff has become heterogeneous with the induction of specialists, agricultural experts, technical experts, etc. The problem of fitting the technical staff and the main specialists in the main stream has become complex.

**h) Lack of Efficiency** - The job content of managerial and other personnel has become more complex demanding innovativeness as well as accounting expertise. The staff recruited has to be taught everything from scratch in a short term and the training facilities are not adequate to cope with the immensity of the task. This has resulted in putting into position staffs who are not adequately experienced in all the spheres of a bank working and consequently efficiency has suffered.

**(III) Regional Rural Banks:**

The Working Group on Rural Banks (GoI, 1975)\(^25\) recommended the establishment of Regional Rural Banks (RRBs) in the country with the objective of spreading banking facilities in rural areas where even co-operatives are not in a position to cater to the credit needs of the rural society and to provide credit facilities at lower rate of interest, especially to the target group, which consisted of small and marginal farmers, rural artisans and small traders, and, to inculcate the habit of thrift and savings. In addition to this RRBs were established to supplement commercial banks as i) inspite of the impressive progress of the rural branches of commercial banks, there was no hope of their spreading to all the unbanked pockets, even in the course of a decade. ii) commercial banks suffered from two deficiencies in relation to rural credit i.e. (a) lack of rural background, and (b) high cost structure of operations. The main aim was that, the farmers as well as the rural poor could be saved from the clutches of private moneylenders, who charge a very exorbitant rate of interest.

**(i) Organisation and Functions of Regional Rural Banks:**

The RRBs combine the basic features of the commercial banks and co-operative societies. They are basically the scheduled commercial banks as these banks have been sponsored by the leading nationalised banks and are most modern in their outlook, having access to the money market and business organisational ability to mobilise the deposits, the features possessed by the commercial banks. Similarly they have local feel and familiarity with the local problems which the co-operative 'societies have. But on the basis of attitudinal and operational ethos RRBs are different from commercial
banks and co-operative societies. The Regional Rural Banks are entrusted with the following functions to perform:

- The RRBs are mainly required to open branches in the rural areas. While opening branches, the RRBs are expected to spread their branch network in remote rural areas and in rural hinterlands where there is larger concentration of economically weaker sections.

- The RRBs are required to mobilise deposits as far as possible from the small men living in remote rural areas. The aim is to promote saving and investment habit of the rural people who were earlier lacking these habits.

- They are required to dispense credit in favour of the economically weaker sections of population in the remote rural areas as in the past, the weaker sections failed to procure adequate amount of credit from either co-operative banks or commercial banks. While granting credit, the RRBs are expected in particular to cater to the needs of small and marginal farmers, agricultural labourers and landless workers.

- To provide other banking facilities like remittance of funds and safe keeping of deposits and valuables etc. which are presently provided by commercial banks.

- They are required to avoid competition as far as possible with other financing agencies like co-operative banks and commercial banks operating in the rural areas. Their role will be mainly to supplement and support the efforts of other lending agencies in the rural areas.

(iii) Limitations of Regional Rural Banks:

(a) Organisational Problems - There is multi-agency control over RRBs which has created lack of uniformity in their functioning. The process of recruitment and training of RRB staff has not received adequate attention. The urban and pro-rich bias seems to prevail in the RRB staff, and this has not evoked confidence in the rural poor. Lastly, the organisational problems got compounded by the unplanned and unwieldy growth of these banks and branches opened under pressure from the State governments.

(b) Inadequate Deposit Mobilisation - The deposit mobilisation of RRBs has remained at a very low level. The area of operation for each RRB is confined to a district only. In some districts, the number of poor person is so large that they are
unable to save anything in the bank due to poverty and low per capita income. The weaker section population in the rural areas who have very low saving capacity, the deposit mobilisation stands at a lower level. This seriously hampers their business activities. Due to poor deposit mobilisation the RRBs have heavily depended upon external financing agencies like sponsor banks and NABARD for borrowing purposes.

(c) **Poor Recovery of Loans** - The most important problem confronting the operation of the RRBs is the problem of recovery of loans. Recovery position of RRBs is as bad as their recovery has varied in between 51 per cent to 61 per cent. Thus, overdues have varied in between 39 percent to 19 per cent. The reasons for poor recovery of loans and mounting overdues are; inadequate supervision and follow up action to assess the end use of credit by RRBs due to inadequate staff in bank, poor identification of beneficiaries, inadequate generation of output and income by the beneficiaries, poor marketing facilities, wilful default, droughts and floods, lack of legal and administrative support from the State government and government policy of waiving loans etc.

(d) **Presence of Malpractices** - The RRBs are primarily required to provide credit to the weaker sections. It is often found that the well-to-do persons in the locality through their influence have managed to procure a sizeable amount of credit from the RRBs. At times, they have utilised weaker section borrowers, to procure funds from the regional rural banks and later pursued them to relent the same at a higher rate of interest. After procuring these funds the vested interest class engage themselves actively in money lending business. This leads to serious diversion of resources from useful lines to unproductive channels.

(e) **Uncertain Future of RRBs** - Due to poor deposit mobilisation, high mounting of overdues, increased losses in RRBs, lack of viability and poor morale of the staff of the bank etc. have resulted in the propagation of the idea of either winding up the RRBs altogether or merging them with the rural branches of commercial banks. The balance of opinion is in favour of merging the banks with rural branches of sponsor banks.

(f) **Mounting Losses leading to Non-Viability** - Many had completely wiped out their equity and reserves and in some the losses were eating into their deposits. This was indeed an unsustainable situation. A number of factors had contributed to the problem of mounting losses: First, the RRBs are so structured as to confine their lending to weaker sections where the interest earned in loans is the lowest in the banking system.
Second, low margins coupled with high cost of servicing a large number of small accounts added to the losses. Third, in the absence of loans which could yield higher returns, RRBs did not have any scope for cross-subsidisation like commercial banks. Fourth, opening of RRB branches year after year added to the overhead costs without proportionate increase income. Lastly, the economic environment of many RRB branches is not satisfactory.

(g) Management Problems - Since the RRBs are district level small institutions, the sponsor banks have been deputing only middle-management staff to run them. Such staff finds difficult to take independent decisions in a new environment. In addition, meetings of the board of directors of RRBs are not held regularly and a large number of non-official directors do not show much interest in the working of the banks. Moreover, a number of problems crop up due to the multi-agency control of the RRBs and the functioning of RRBs is also not uniform in all the States/districts.

(B) Non-Institutional Sources:

The share of formal credit in Indian agriculture has increased from 7 percent in 1950-51 to 63 percent in 1981-82 (RBI, 1987). But despite an adequate supply of formal credit in many cases the small and marginal farmers in India depend on informal credit not least because formal credit is not available in time. The non-institutional sources are that which operate outside the provision of Indian Banking Companies Act. Here private accounts are maintained that are not subject to open inspection by any official or semi-official organisations. It is not amenable to any sort of public or semi-public control. “The unorganised money market is characterised by blending of money dealing with other types of economic activities, great amount of informality in dealing with customers, personal contacts with customers, fairly simple system of keeping accounts, fairly great amount of flexibility in matters of loan operations and by secrecy that shrouds the financial transactions” (Ghatak, 1976). Non-institutional sector consists of a wide range of sources and systems, some of which have been functioning since time immemorial while some have started with changes in economy. The Figure clearly presents the flow of this source of credit.
(I) Moneylenders:

These have been the major source of providing agricultural finance. They have been taking lead in agricultural financing, both in terms of loans and the volume of business. There is no standard pattern or system followed by moneylenders and they differ in their characteristics throughout the country. More so, there is no special class or community involved in it except for professional moneylenders (Mamoria and Saksena, 1982)\textsuperscript{28}.

(a) Professional Moneylenders:

In almost all regions in India, some form of professional moneylenders prevail and are known by different names such as ‘Seth’, ‘Sahaokar’, ‘Munim’ etc. They are either traders or rich agriculturists. They are more business oriented and strict in collecting or repayment and are ready to lend large amount depending upon the repayment capacity of the borrowers.
(b) Non-Professional Moneylenders:

These are not entirely in money lending business but are important sources especially for small farmers and those who do not want to get into the clutches of professional moneylenders. There is no fixed group involved in this and any well-off person who is willing to lend money to the needy can take up this work. Generally rich landlords lend money to their tenants or to small farmers. Merchants and comparatively well-off agriculturists are involved in lending money. Relatives, friends, neighbours however, are the first to be approached by the needy people because in their case pressure of employment is less and interest rate too is low (Ibid.)\(^29\).

(II) Indigenous Bankers:

These are groups or association of people generally of the same community or similar profession involved in banking. These operate as banks as receive deposits and give loans. Jain, Lala and Bania in Rajasthan and Madhya Pradesh, Marwari, Jain, Agarwal, and Maheshwari in Uttar Pradesh, Khatri in Punjab, Chettiar in Tamil Nadu, Bohras and Shroffs in Gujarat, and Marwari Kayas of Assam etc. are some examples. There are about 2000 such communities involved in indigenous banking. They provide loans on the basis of promissory notes for productive purposes and are also involved in mobilising savings by people (Desai, 1979)\(^30\).

The system of indigenous banking in India dates back to ancient period. Until the middle of the nineteenth century the indigenous banking constituted the bulk of the Indian financial system. But the advent of the British had an adverse impact on their business. With the growth of commercial and co-operative banks geographically and functionally, especially since the mid-1950s, the area of operations of indigenous bankers has contracted further. Still in the western and southern parts of India these continue to operate as traditional-style bankers.

There are three types of indigenous bankers: (i) those whose main business is banking; (ii) those who combine banking business with trading and commission business; and (iii) those who are mainly traders and commission agents but do a little banking business also.

(III) Nidhis:

These are some loan societies and were initiated in south India in the middle of the 19\(^{th}\) century. These are a type of semi-banking institution registered under the Indian Company’s Act. They act as mutual benefit funds and so deal only with their
members. The major source of their funds is deposits from the members. They promote savings among members and also have share capital withdrawal in monthly installments. They provide loan for such purposes as house construction or repairs etc. and at cheap rate of interest so as to protect the members from moneylenders. The loans are mostly secured. Their main features are to; encourage thrift, mobilise small savings, promote corporate effort and promote planned expenditure. Nidhis are highly localised, single office institutions that offer low-cost financial intermediation services to their members. But the deposits mobilised by them are not large, they are weak in management and are often engaged in earning higher profit at the cost of the borrowers.

(IV) Chit-Funds:

It is a system based on association, confidence & honest dealing. It promotes regular savings and provides cheap credit. It has been very popular in rural areas especially in South India. The loan is given for purchase of land, jewellery, marriages, trade and settling prior debts. However, some chit funds have been found to be involved in gambling business.

From the above it appears that the non-institutional sources show a vast network for credit provision in rural areas. The extent of credit provided by these institutions has been wide and large over the decades.

3.4 Agricultural Credit System:

The story of agricultural and rural credit in India is as old as the story of misery and sufferings of the rural farmers due to crop failure and other difficulties. During the drought condition and scanty rainfall, which so often characterised Indian agriculture, small and poor farmers used to get foodgrains from rich farmer, who have a surplus foodgrains all the time, on the condition that the same would be returned with interest after harvesting the crop. This was known as ‘waldi’ system in Maharashtra and was prevalent in almost all part of India. The persons engaged in such activities were the village traders, feudal lords who gradually moved towards a full-fledged job of money lending and were called money-lenders, who still held their position in rural areas. In traditional agriculture in India, credit is an inseparable part of the “tribute system” which flourished under the colonial rule and the remnants of which are seen even today in rural areas. Tribute system is a direct method of surplus extraction from the
peasantry in the form of rent and land revenues. Usurious extraction is just a complementary system to it. Income generated from direct extraction through tribute system compels peasantry to fall in the death trap of usury. The rural poor submerged in extreme poverty takes loan to meet their production requirement and even consumption needs. Once the peasant takes loan, it is not possible to get rid of that even at the cost of his existing wealth including land. The cultivator becomes a share tenant on his own land as the volume of debt always moves up at a very vast rate. The debt passes through one generation to another leading to the emergence of a big class of a bonded labours. So the Indian farmer is thus born in debt, lives in debt and dies in debt.

(A) Agricultural Credit System before Independence:

The indebtedness of peasantry became worse under the colonial rule due to two reasons. First, under the new land revenue settlement (permanent settlement) every landlord had to pay a fixed amount of annual revenue to government before a particular date (30th chaitra), failure to do which would result in confiscation of zamindari and its sale through auction. The exorbitantly high land revenues forced the landlords to raise their degree of exploitation and they compelled the peasants to the death trap of indebtedness. Secondly, decline in handicrafts or what may be called de-industrialisation forced the jobless people to seek a livelihood in agricultural sector, increasing the pressure on land. The combination of these two was nothing but worsening of the standard of living of peasantry, sharp decline in their income and a desperate rise in the demand for consumption loans. So the problem as inherently built in the system. The growing indebtedness along with the drought conditions at the end of the nineteenth century led to growing discontent.

Such exploitative acts of the private money-lenders, made the Imperial British to pass legislation in this context. Some of the earliest steps taken by the British government in direction of organisation of agricultural credit involve following:

- Introduction of taccani loans in 1793, for providing loans at low rates of interest for agricultural improvements mainly for the digging of wells.
- Land Improvement Act was passed in 1871, which was amended in 1876 and repealed in 1883 as a more comprehensive legislation named the Land Improvement Loans Act, 1883. The purpose of this Act was to consolidate and amend the law relating to loans of money by the government for agricultural
improvements which included construction of wells, tanks and preparation of land for agricultural purposes etc.

- Agriculturists Loan Act passed in 1884 to provide loans to the owners and occupiers of arable land, for the relief of distress, the purchase of seeds or cattle etc. Under this Act the agriculturists could borrow from the government for productive purposes at the rate of about 6 percent (Mamoria and Saksena, 1982)\(^3\).

Government finance continued to be channeled under the provisions of the Act of 1883 and 1884, but there were defects in the working of the acts as these were not aimed to cure the basic malaise of agricultural underdevelopment and rural-indebtedness, but were kneejerk reactions to the problems mainly arising out of natural causes such as uneven and inadequate rainfall and droughts. The Frederic Nicholson’s Report of 1892 (Paramjyothi, 1984)\(^3\) stated that, the state must assist the development of organised credit. It must remove all disabilities and obstacles which prevent the lender and borrower from meeting and it must stimulate competition with the moneylender by suggesting and favouring the establishment of credit associations of all class. It must legislate for the formation and management of such associations like the co-operative class of banks.

In 1903, the Irrigation Commission pointed out a number of defects in the agricultural credit system, such as high rates of interest, rigidity of collection, delays in distribution etc. Thus, co-operative movement was started in India as a defense mechanism against the exploitative practices of the money lenders. Co-operative finance gained recognition with the Co-operative Credit Societies Act, 1904. It was however limited to primary co-operative credit societies only. The Co-operative Credit Societies Act of 1912 was made applicable to all types of societies, credit and non-credit. The real stimulus to the co-operative movement came with the recommendation of Maclagen Committee in 1915. The Committee had recommended the setting up of a three-tier organisation comprising: primary agricultural credit societies at village or base level, central banks at district level and provincial banks at the apex or provincial level (Ibid.)\(^3\).

Accordingly changes in the co-operative credit structure were initiated by the Government of India and co-operation was made a financially transferred subject with the Government of India Act 1919. There was a mix response to this movement as it
expanded rapidly in some states but lagged behind in others. Highlighting the importance of co-operative movement the Royal Commission on Agriculture (1926) stated, “If co-operation fails there will fail the best hope of India” (GoI, 1926). The greatest hope for the salvation of the rural masses from their crushing burden of debt lies in the growth and spread of a healthy and well organised co-operative movement and local governments should therefore give the movement all the encouragement possible. Two committees set up by the Government of India in 1945 had recommended on the working of the co-operative credit institutions. The Agricultural Finance Sub-Committee of the Policy Committee on Agriculture, Forestry and Fisheries 1945, emphasised the role of the co-operative agencies in financing agriculture. The Co-operative Planning Committee was set up in 1945 to draw up a co-operative plan for the country had recommended that the existing three-tier co-operative institutions should be suitably strengthened and provided with the necessary share capital and finance. Thus at the time of independence finance was being advanced to agriculturists by the government in the form of loans and grants through the co-operative credit agencies and to a very small extent by commercial banks. But all these accounted only for 7.3 percent of the total credit needs of agriculture which was then estimated to be between Rs. 500 crores to Rs. 800 crores. A major portion of these credit needs continued to be met by the private moneylenders (RBI, 1954). Pattern of supply of agricultural credit at the time of independence and the borrowings from each agency to the total borrowings of cultivators can be seen in the following Table-2 and Figure-4.

**Table-2: Composition of Agricultural Credit in India (1947)**

<table>
<thead>
<tr>
<th>Credit Agency</th>
<th>Percentage Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>3.3</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>3.1</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>0.9</td>
</tr>
<tr>
<td>Landlords</td>
<td>1.5</td>
</tr>
<tr>
<td>Agro-moneylenders</td>
<td>24.9</td>
</tr>
<tr>
<td>Professional money lender</td>
<td>44.8</td>
</tr>
<tr>
<td>Trader &amp; Commission agents</td>
<td>5.5</td>
</tr>
<tr>
<td>Relatives</td>
<td>14.2</td>
</tr>
<tr>
<td>Others</td>
<td>1.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>

*Source: AIRCS 1954, Vol. II, RBI.*
(B) Agricultural Credit System during Post-Independence Era:

At the time of independence India started with the colonial inheritance with a stagnant agriculture and small banking base. In November 1949, the Government of India appointed the Rural Banking Enquiry Committee to consider the measures that could be immediately adopted for the extension of banking facilities in rural areas (GoI, 1949)\(^{36}\). The growing disparity in the allocation of rural credit was recognised by the government and the Committee favoured a co-operative credit structure.

A comprehensive study of the problem of rural credit and related issues was undertaken for the first time during 1951-54 by the All India Rural Credit Survey Committee set up by the Reserve bank of India. The Committee made far reaching recommendations which laid the foundation of the institutional framework for establishing a sound credit delivery system for financing agriculture and allied activities. The Committee documented the fact that the co-operative banking institutions and the government sector provided only 7.3 percent of the loans raised by the cultivator, while private sources (moneylenders and traders) provided around 70 percent of the total borrowing at usurious rates of interest and rest also from the non-institutional sources. The Committee recommended an “integrated scheme of rural credit” to strengthen the system. One of the main recommendations of the committee for developing the institutional framework and strengthening it was rebuilding of co-operatives at all the levels within each state, district, taluka and village level.
operatives. The highlights of the scheme were (a) state partnership in co-operative credit institutions through the contribution of a part of the share capital, (b) full coordination between the credit disbursement and the other allied economic activities like marketing and processing and (c) improving administrative efficiency by appointing trained personnel d) avoiding state interference in its day-to-day working e) mobilising rural savings through the direct participation of the cultivator, labourer, and worker and the savings so mobilised should be utilised for the benefit of rural areas. The committee specially emphasised the role of the co-operative banks, though their progress has been at a very tardy pace and concluded: ‘‘co-operation has failed, but co-operation must succeed’’ (RBI, 1954)\textsuperscript{37}.

The Committee’s recommendations also resulted in many innovative steps in the field of institution building like the conversion of the Imperial bank into State Bank of India, the setting up of the National Co-operative Development Corporation, National and State Warehousing Corporations, the creation of wide network of co-operative training institutions, setting up of two funds by Reserve bank of India namely the National Agricultural (long term operations) fund and National Agricultural Credit (stabilisation) fund etc.. All these steps were aimed at stimulating the flow of credit to agriculture and simultaneously integrating credit with agricultural processing and marketing. A part from this, a number of committees appointed in the early 60’s, the Committee on Co-operative Credit (1960), the Committee on Taccavi loans and Co-operative Credit (1962), Mirdha Committee on Co-operation (1965) also emphasised the need for strengthening the co-operative credit movement and extending its coverage and participation.

The RBI undertook a resurvey titled the All India Rural Debt and Investment Survey 1961-62 to assess the major changes since the rural credit survey (1951-52). According to this survey, over the 10 years borrowing from the co-operatives had increased from 3.1 percent to 15.5 percent but that private moneylenders still dominated. Moreover, much progress had not occurred in the co-operative sector in some parts of the country. Table-3 and Figure-5 reflect the scenario.
Table-3: Composition of Agricultural Credit in India (1961)

<table>
<thead>
<tr>
<th>Credit Agency</th>
<th>Percentage Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>2.3</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>15.5</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>0.6</td>
</tr>
<tr>
<td>Professional Moneylender &amp; Traders</td>
<td>58.0</td>
</tr>
<tr>
<td>Landlords &amp; Others</td>
<td>14.5</td>
</tr>
<tr>
<td>Relatives</td>
<td>8.8</td>
</tr>
<tr>
<td>Others &amp; Unspecified</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: AIDIS, 1961, RBI.

Figure-5: Composition of Agricultural Credit in India (1961)

The Reserve Bank of India played a major role in building up the co-operative movement through its financial supervision, arrangements for training, loans to states for participation in the share capital of co-operative banks, and advances to the co-operative banks. In the third plan (1961-66), it was proposed to set up the Agricultural Refinance Corporation later called the Agricultural Refinance and Development Corporation (ARDC). In July 1966 the Reserve Bank of India set up the All India Rural Credit Review Committee to undertake a comprehensive review of the agricultural credit system and submitted its Report in 1969. The Committee made several recommendations. It suggested a dynamic role to the ARDC. During this period due to the changes in the agricultural scenario of the country especially the introduction of new agricultural strategy in cultivation i.e. green revolution demanded
a larger share of credit from institutional agencies and the co-operatives were not able to meet this increased demand. Thus, the Committee recommended inducting the commercial banks to supplement the effort of co-operatives in the form of Multi-agency approach. The All India Rural Credit Review Committee emphasised that the requirement of the agricultural sector was so large and diverse that the commercial and co-operative banks can both play a mutually complementary role without getting into conflict with each other (RBI, 1966)\textsuperscript{38}.

On the other hand, there was a growing concern over the pattern of distribution of bank credit and some conscious efforts to alter it by inducing a greater flow of finance for small-scale industry and, at the same time, by arming the Reserve bank with direct powers of intervention over the managerial affairs of commercial banks (Ghosh, 1979)\textsuperscript{39}. This concern was required to be reconciled with the framework of the commercial banking system through the policy of social controls. Based on the suggestions of various study groups the Banking Laws (Amendment) Bill 1967 was introduced in the Lok Sabha on December 23, 1967. With this Amendment ‘social control’ on banks was instituted. The basic objective of the social control policy was to ensure, in the immediate future, an equitable and purposeful distribution of credit, within the resources available, keeping in view the relative priorities of development needs (GoI, 1967)\textsuperscript{40}. The major instrument, for achieving this policy, was the establishment of National Credit Council at the All India level with the objective of “assessment of the demand for bank credit from various sectors of the economy” and “determining priorities for grant of loans and advances for investment, having regard to the availability of resources and requirements of the priority sectors, in particular agriculture, small scale industries and exports (Ghosh, 1979)\textsuperscript{41}. The National Credit Council found that not even 1 percent of India’s villages were served by commercial banks, also noted that while industry accounted for a mere 15 percent of national income, its share in commercial bank credit was nearly 67 percent, on the other hand, agriculture that contributed 50 percent of GDP virtually got nothing from banks (Shah, 2007)\textsuperscript{42}. Thus, the commercial banks were mandated to achieve certain targets and sub-targets under priority sector lending. Direct finance to agriculture and allied activities is to reach at certain specified levels over a period of time.
(C) Agricultural Credit System during Post-Nationalisation Era:

The landmark for the banking system was the year 1969 in the country. The study group on the “Organisational Framework for Implementation on Social Objectives”, one of the five study groups set up National Credit Council (NCC) headed by Dr. D.R. Gadgil made some significant recommendations after identifying the credit gaps for the key sectors of the economy, including agriculture, and also the skewed nature of commercial banking. The nationalisation of 14 commercial banks on 19 July, 1969 reflected the social policy goals of the banking system. The Prime Minister, Mrs. Indira Gandhi, in her broadcast address explained to the nation that the policy of nationalisation was intended to “accelerate the achievements” of the objectives of social control and the elements which were highlighted were “(i) removal of control by a few, (ii) provision of adequate credit for agriculture and small scale industry and exports, (iii) giving of a professional bent to management, (iv) encouragement of new classes of entrepreneurs, and (v) the provision of adequate training as well as terms of service for bank staff” (Ghosh, 1979)33. The other measures taken in tune with the nationalisation of the banks were the restriction of entry into the banking system, the licensing system of branch expansion and opening up of branches in the rural areas. Bank nationalisation and the associated public policies on banking and financial sector were predicated on a strong assumption of the need for promoting financial intermediation by building institutions, expanding their geographical spread, mobilising savings and inducing better regional, sectoral and functional reach of institutional credit in India. Such a system of supply driven institutional development could neither be left to market forces nor to the initiative of private entrepreneurship (Shetty, 2005)44. The nationalisation of the banking system was more of a political act, but there were strong economic reasons for it. At that time the need of a fragmented and imperfect credit market was to be regulated by the monetary authorities, as when it is left to the free market forces, the imperfections tend to widen. The economic arguments regarding bank nationalisation had been presented in a lecture by Dr. K.N. Raj in 1965, four years before nationalisation. According to him, the commercial banks have a natural bias, “to advance credit to segments of population which have already developed banking habits, and to be interested in others only to the extent that they offer deposits on a permanent basis (such as through savings deposits) which would bring cash into the banking system without causing
outflows of cash from it” (Raj, 1974). This recommendation was accepted and implemented by the Government of India in fourth Five Year Plan (1969-74). Thus the predominant role played by the co-operatives in the supply of institutional credit lasted from 1951-52 to 1968-69 and there was a shift in emphasis from co-operatives to multi agency approach. This was because of limitations of resources and the weaknesses of co-operative sector. The change in the compositional share of agencies in agricultural credit is clear from the following Table-4 and Figure-6.

**Table-4: Composition of Agricultural Credit in India**

<table>
<thead>
<tr>
<th>Credit Agency</th>
<th>Percentage Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>2.4</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>22.0</td>
</tr>
<tr>
<td>Government etc.</td>
<td>7.1</td>
</tr>
<tr>
<td>Insurance</td>
<td>0.1</td>
</tr>
<tr>
<td>Provident Fund</td>
<td>0.1</td>
</tr>
<tr>
<td>Total Formal</td>
<td>31.7</td>
</tr>
<tr>
<td>Agricultural Money lender</td>
<td>23.0</td>
</tr>
<tr>
<td>Professional Money lender</td>
<td>13.1</td>
</tr>
<tr>
<td>Landlord</td>
<td>8.1</td>
</tr>
<tr>
<td>Traders</td>
<td>8.4</td>
</tr>
<tr>
<td>Relatives &amp; Friends</td>
<td>13.1</td>
</tr>
<tr>
<td>Others</td>
<td>2.6</td>
</tr>
<tr>
<td>Total Informal</td>
<td>68.3</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

*Source:* NSSO Survey 48th and 59th Round; Situation Assessment Survey of Farmers Indebtedness of Farmer Households (2003), AIDIS.

*Note:* NA- Not available.

It is evident from the Table-4 that the total share of institutional credit increased from 31.7 percent in 1971 to 63.2 percent in 1981 and further to 66.3 percent in 1991. On the other hand, the share of non-institutional credit in total decreased from 68.3 percent in 1971 to 36.8 percent in 1981 and further to 30.6 percent in 1991. The comparative share of commercial banks in total credit has also increased in a manner like; it has increased from 2.4 percent in 1971 to 28.9 percent in 1981 and 35.2 percent in 1991. The comparative share of co-operatives has shown an improvement from 22.0
percent in 1971 to 29.9 percent in 1981 but declined to 23.6 percent in 1991. However, the Situation Assessment Survey (SAS) of NSSO revealed that the share of non-institutional credit took a reverse swing, which is a cause of concern (NSSO, 2003). The share of informal sources has increased to 38.9 percent of which moneylenders have contributed 26.8 percent and others 12.1 percent. Notwithstanding their wide network, co-operative banks, particularly since the 1990s lost their dominant position to commercial banks. The share of co-operative banks (13 percent) during 2008-09 was less than three fourths of what it was in 1992-93 (62 percent), while the share of commercial banks (33 percent to 80 percent) including RRBs (5 percent to 9 percent) almost doubled during the above period (GoI, 2009). For more clarity Table-4 is presented in the form of bar diagram in Figure-6.

Figure-6: Composition of Agricultural Credit in India (1971-2002)

One of the major achievements of the nationalisation of the banking system was the rapid expansion of branches in rural areas by the scheduled commercial banks, which contributed towards accelerating the process of developing banking habits even in rural areas (Deb, 1988).

Table-5 and Figure-7 exhibit the increasing pattern of opening up of commercial bank branches in rural areas. The number of rural branches of banks (including RRBs) increased from a mere 1443 in 1969 to around 35,000 in the early 1990s. The average branch expansion in rural area after nationalisation till 1990 was
Table-5: Growth of Rural Bank Branches in India (1969-1990)

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Rural Bank Offices</th>
<th>Percentage to Total Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>1443</td>
<td>17.6</td>
</tr>
<tr>
<td>1970</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1971</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>1972</td>
<td>5274</td>
<td>36.0</td>
</tr>
<tr>
<td>1973</td>
<td>6024</td>
<td>36.5</td>
</tr>
<tr>
<td>1974</td>
<td>6447</td>
<td>35.9</td>
</tr>
<tr>
<td>1975</td>
<td>7112</td>
<td>35.5</td>
</tr>
<tr>
<td>1976</td>
<td>8588</td>
<td>36.6</td>
</tr>
<tr>
<td>1977</td>
<td>10856</td>
<td>40.3</td>
</tr>
<tr>
<td>1978</td>
<td>12534</td>
<td>42.5</td>
</tr>
<tr>
<td>1979</td>
<td>14171</td>
<td>44.0</td>
</tr>
<tr>
<td>1980</td>
<td>16111</td>
<td>46.9</td>
</tr>
<tr>
<td>1981</td>
<td>19453</td>
<td>51.2</td>
</tr>
<tr>
<td>1982</td>
<td>21626</td>
<td>53.0</td>
</tr>
<tr>
<td>1983</td>
<td>23782</td>
<td>52.4</td>
</tr>
<tr>
<td>1984</td>
<td>25541</td>
<td>52.9</td>
</tr>
<tr>
<td>1985</td>
<td>29408</td>
<td>54.6</td>
</tr>
<tr>
<td>1986</td>
<td>29700</td>
<td>55.7</td>
</tr>
<tr>
<td>1987</td>
<td>30585</td>
<td>56.2</td>
</tr>
<tr>
<td>1988</td>
<td>31641</td>
<td>56.2</td>
</tr>
<tr>
<td>1989</td>
<td>33572</td>
<td>57.3</td>
</tr>
<tr>
<td>1990</td>
<td>34867</td>
<td>58.2</td>
</tr>
<tr>
<td>Mean</td>
<td>18437</td>
<td>45.9</td>
</tr>
<tr>
<td>SD</td>
<td>10905.04</td>
<td>10.67</td>
</tr>
<tr>
<td>CV</td>
<td>169.06</td>
<td>430.77</td>
</tr>
</tbody>
</table>

Source: Banking Statistics: Basic Statistical Returns, Various Issues, RBI.

Figure-7: Growth of Rural Bank Branches in India (1969-1990)

Source: Table-5
18437 and average percentage share in total was 46 percent, those were very impressive. The value of CV showed the high variation in both branch expansion and share in total branches with 169 percent and 431 percent respectively. The most of this increase was in unbanked areas. The number of banked locations rose in this period from around a thousand to over 25,000. The share of rural branches went up from 17.6 to 58.2 percent during the same period. The banking indicators showed an improvement immediately after the bank nationalisation. “The growth in the agricultural credit from the scheduled commercial banks was appreciable after the introduction of social control and the nationalisation. The total credit was only Rs. 67 crores in March 1968 but within a little more than one year, at the end of June 1969 it almost trebled to Rs. 188 crores” (Ibid.)\(^4^9\). The total outstanding advances to agriculture as a percentage to grand total of advances of scheduled commercial banks’ increased from 2.2 percent in March 1968 to 9 percent in June 1973 (Ibid.)\(^5^0\). During this period, the Reserve Bank of India’s main role was to meet the social objectives and thus policies such as interest rate control and programmes for directing credit to target areas were implemented. As an outcome of this, the policies of “priority sector lending” to agriculture and small scale industries came into the forefront. The banks were given special instructions to open branches in the rural areas, mobilise household savings, and offer lower lending rates. The policy initiative taken by the government in regards to rural credit, are well documented in the words of the former Governor of Reserve Bank of India, Dr. C. Rangarajan, “The main thrust of Indian public policy towards rural credit has therefore to ensure that sufficient and timely credit, at reasonable rates of interest, is made available to as large a segment of the rural population as possible” (Rangarajan, 1996)\(^5^1\).

The post-nationalisation period was marked by the allocation of commercial banks’ credit to the agriculture. Table-6 sketches the trends in scheduled commercial banks’ advances to agriculture. All the indicators show that the banking sector exhibited an improved performance after bank nationalisation. During 1970s and mid-1980s, the total amount disbursed to agriculture by scheduled commercial banks’ increased by almost 22 times. The total amount of loans outstanding in agriculture from the scheduled commercial banks’ increased from Rs. 342 crores in June, 1970 to Rs. 7660 crores in June, 1985. The trend of the share of direct credit to agriculture exhibited a continuous increase during this period. In the aggregate of agriculture
credit from the commercial banks, the share of direct credit to agriculture increased noticeably over the years from 28.4 percent in 1969 to 88.4 percent in 1984. The amount outstanding rose from only Rs. 54 crores to 5789 crores over the same period, a growth of 107 times in 15 years (Table-6).

**Table-6: SCBs Outstanding Advances to Agriculture (1968 to 1986)**

<table>
<thead>
<tr>
<th>Year (June end)</th>
<th>Direct Finance</th>
<th>Indirect Finance</th>
<th>Total for Agriculture</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>Share</td>
<td>Amount</td>
</tr>
<tr>
<td>1968</td>
<td>NA</td>
<td>NA</td>
<td>67</td>
</tr>
<tr>
<td>1969</td>
<td>54(28.4)</td>
<td>134(71.6)</td>
<td>188</td>
</tr>
<tr>
<td>1970</td>
<td>184(53.8)</td>
<td>158(46.2)</td>
<td>342</td>
</tr>
<tr>
<td>1971</td>
<td>236(61.8)</td>
<td>146(38.2)</td>
<td>382</td>
</tr>
<tr>
<td>1972</td>
<td>268(60.8)</td>
<td>172(39.2)</td>
<td>440</td>
</tr>
<tr>
<td>1973</td>
<td>342(64.3)</td>
<td>190(35.7)</td>
<td>532</td>
</tr>
<tr>
<td>1974</td>
<td>436(67.3)</td>
<td>211(32.7)</td>
<td>647</td>
</tr>
<tr>
<td>1975</td>
<td>564(66.8)</td>
<td>279(33.2)</td>
<td>843</td>
</tr>
<tr>
<td>1976</td>
<td>791(72.4)</td>
<td>301(27.6)</td>
<td>1092</td>
</tr>
<tr>
<td>1977</td>
<td>1031(74.7)</td>
<td>350(25.3)</td>
<td>1381</td>
</tr>
<tr>
<td>1978</td>
<td>1405(71.6)</td>
<td>556(28.4)</td>
<td>1961</td>
</tr>
<tr>
<td>1979</td>
<td>1946(77.2)</td>
<td>575(22.8)</td>
<td>2521</td>
</tr>
<tr>
<td>1980</td>
<td>2418(76.7)</td>
<td>734(23.3)</td>
<td>3152</td>
</tr>
<tr>
<td>1981</td>
<td>3033(72.9)</td>
<td>1127(27.1)</td>
<td>4160</td>
</tr>
<tr>
<td>1982</td>
<td>3831(71.1)</td>
<td>1273(24.9)</td>
<td>5104</td>
</tr>
<tr>
<td>1983</td>
<td>4260(73.6)</td>
<td>1520(26.4)</td>
<td>5786</td>
</tr>
<tr>
<td>1984</td>
<td>5789(88.4)</td>
<td>762(11.6)</td>
<td>6551</td>
</tr>
</tbody>
</table>

Source: Report on Currency and Finance (Various Issues), and Report on Trend and Progress of Banking in India, RBI.

**D) Agricultural Credit and NABARD:**

Though, the multi-agency approach resulted in the increased flow of credit to agriculture but a number of problems arose such as uncoordinated credit disbursal, diversion to unproductive purposes, inability of the credit agencies to formulate agricultural programmes on the basis of an area approach, overlapping and duplication of banking facilities, lagging recovery, and numerous problems arising out of different systems, procedures, security norms, service charges, interest rates etc. In March 1979, the RBI appointed Committee to Review the Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) under the chairmanship of B. Sivaraman to suggest improvements. The major outcome of the CRAFICARD’s
recommendations was the separation of the Agricultural Credit Department (ACAD) from the Reserve bank of India which handled refinance for the co-operative credit system, and its merger with Agricultural Refinance and Development Corporation (ARDC) which had earlier been set up by RBI to exclusively handle investment finance for agriculture. As a result the National Bank for Agricultural and Rural Development (NABARD) was set up in July 1982 as an apex bank for providing credit or refinance of the promotion of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity for rural areas. NABARD has to take over from RBI the over issuing of the entire rural credit system including credit for rural artisans and village industries and the statutory inspection of co-operative banks and RRBs on an agency basis. The very preamble of the NABARD Act 1981 talks of the establishment of the NABARD as “a bank for providing credit for the promotion of agriculture, small scale industries, cottage and village industries, handicrafts, rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity of rural areas, and for matters concerned therewith or incidental thereto” (AINBEA’s Study, 1998). The National Agricultural Credit (Long term operations) Fund and the National Agricultural Credit (Stabilisation) Fund were transferred to NABARD from the apex bank of the country. In the process, NABARD and its other subsidiary units, the co-operative banks and the regional rural banks (RRBs) became dependent on the RBI for funds and transfers. NABARD was established in 1982 in order to assume RBI’s agricultural refinance activities. Its main sources of funds are borrowings from the Reserve Bank either directly (general line of credit) or indirectly through the National Rural Credit Fund which was established by the RBI. NABARD’s equity is also mainly financed by RBI. To a lesser extent NABARD uses compulsory deposits from commercial banks i.e., from Rural Infrastructure Development Fund and issues bonds” (FAO, 1999).

As an apex refinancing institution NABARD purveys all types of credit needed for the farm sector and rural development. It is also vested with the responsibility of promoting and integrating rural development activities through refinance. The bank is also providing direct credit to an institution or agency or an individual subject to the approval of the Central Government. It has close links with RBI for guidance and
assistance in financial matters. As an effective catalytic agent for rural development and in formulation of appropriate rural development plans and policy, its role is remarkable.

**Functions of NABARD:**

(i) It helps in planning and operational matters related to credit for agriculture and allied activities, rural artisans, village industries and other rural development activities;

(ii) It extends refinance to commercial banks for term loans in relation to agriculture and rural development;

(iii) It provides short term credit to state cooperative banks, RRBs, and any other financial institution notified by RBI for a period not exceeding 18 months by way of refinance for agricultural operations, marketing of crops and marketing and distribution of agricultural inputs.

(iv) It makes direct loan by way of refinance to all eligible institutions for a period not exceeding 25 years.

(v) It provides finance for production and marketing activities of rural artisans, cottage industries, small-scale industries, handicrafts etc. in the rural areas.

(vi) It facilitates all eligible financial institutions for conversion of production loans into term loans in the times of natural calamities,

(vii) It contributes to share capital and securities of eligible institutions and state governments concerned with agriculture and rural development. It also helps state governments to contribute to the share capital of eligible institutions working for rural development.

(viii) It offers advice and guidance to state governments, co-operative federations and National Cooperative Development Corporation (NCDC) and functions in close contact with central government in matters related to agriculture and rural development.

(ix) It coordinates and monitors all agricultural and rural lending activities with a view to tie up with extension and planned development activities in rural areas; and

(x) It conducts training, consultancy and research relating to agricultural finance and agricultural and rural development.
Authorised share capital of NABARD is Rs. 500 crores and issues and paid-up capital is Rs. 100 crores. NABARD accrues additional funds from borrowings from the Government of India and any institution approved by the Government of India, issue and sale of bonds i.e. Rural Infrastructural Development Bond, borrowings from RBI, deposits from state governments and local authorities and gifts and grants received.

The Sixth Five Year Plan (1980-85) endorsed the setting of NABARD but further noted that mounted overdues had clogged the system of agricultural credit. At the end of June 1985, the share of overdues to demand at the PACS (Primary Agricultural Credit Societies) level was 40 per cent while at the level of LDBs (Land Development Banks) it was 42 per cent. It was further worse in the case of RRBs and commercial banks (Government of India, 1980). According to the Seventh Five year Plan (1985-90) if the trend of writing off agricultural loans by the state government was not reversed and if banks were reduced to institutions providing grants rather than recycling the credit, the banking system would not be able to meet the credit needs of agriculture in future. The eighth five year plan (1992-97) confirmed these apprehensions. The debt relief scheme announced in 1990-91 affected the recovery climate resulting in a lower volume of credit flow (GoI, 1992)\textsuperscript{54}.

### 3.5 First Generation Banking Reforms and Agricultural Credit:

In June 1991, the Government of India announced a new economic policy effecting major policy changes designed to correct the macroeconomic imbalances and effect structural adjustment so as to bring about a more competitive system and promote efficiency in the real sectors of the economy. Financial sector reform is a necessary concomitant of trade and industrial policy liberalisation and in fact is critically important. Hence in August 1991, the Ministry of Finance appointed Narasimham Committee on financial systems to examine all aspects relating to the structure, organisation, functions and procedures of the financial system. The Committee submitted its Report in November 1991 (GoI, 1991)\textsuperscript{55}. Some of the important observations and recommendations of the Committee regarding agricultural credit are presented as follows.

Financial liberalisation typically involves a redefinition of the roles and responsibilities of the principal agents in the financial market. It is the process that
frees the system from financial repression. The recommendations of the Narasimham Committee falls into two broad areas viz. those concerned with improving the efficiency, productivity and profitability of bank operations on the one hand and those related to enhancing their operational flexibility and autonomy in decision making on the other. The Committee did not go into the question of rural credit in its entirety and confined itself only to the role of commercial banks including the RRBs. But some of the recommendations made by the Committee can have some influence on rural banking. The Committee has criticised the statism which has entered into the financial system. The most important aspect of statism has been policy induced rigidities such as an excessive degree of central direction in terms of investments, credit allocations, branch expansion, and even in internal management of the business. There has also been an element of political interference to which the system has been subjected and which has come in the way of the institutions operating on the basis of their commercial judgement and in the framework of internal autonomy. Indian banks have virtually ceased being competitive or innovative. Despite impressive quantitative achievement in resource mobilisation and in extending the credit reach several distortions have, over the years crept into the financial system, especially in respect of allocation of financial services. Productivity and efficiency of the system have suffered, its profitability has been eroded and its portfolio quality has deteriorated. Customer service has been poor, work technology remains outdated and transaction costs are high. In the process several banks and institutions have themselves become weak financially and unable to meet the challenges of a competitive environment. The Committee has observed that between 1969 and 1990, of the total increase of over 51,000 offices as many as 33,600 were in the rural areas and over 7,900 in the semi-urban areas making for a total of over 80 per cent. Further the increase in rural deposits as a proportion of the total increased from three per cent to 15 per cent. The advance to agriculture which stood at five per cent in 1969 has increased to 18 per cent of the aggregate credit as prescribed by RBI guidelines on priority sector lending. In purely quantitative terms this expansion must be regarded as a successful fulfillment of the objectives of the directed credit programme of RBI and government. Fixation of targets for specific sector lending was essentially the means to achieve the broader goals of credit allocation but over the years the means appear to have become ends in themselves. The desire to attain credit targets has meant inadequate attention to
qualitative aspects of lending and consequent rise in loan delinquencies. Over the years competitive populism has affected banking and credit operations. The phenomenon of loan melas was quite contrary to the principles of professional appraisal of bank credit needs. There was hardly a serious appraisal of credit need potential, productive capacity or provision for effective post-credit supervision. Loan waivers have added an additional element of politicisation of banking apart from the severe damage to the concept of credit discipline by encouraging defaults. Altogether the proportion of the infected agricultural credit is estimated to be as high as over 20 per cent. Directed credit programmes have had adverse implications for the profitability of banks also because of the stipulation of concessional lending rates on agricultural credit and the element of subsidy on such credit which now accounts for a significant portions of bank spread. Subsidisation of this type of lending arises from the misconception that socially oriented credit should also be low cost credit. Subsidisation of credit is clearly a case of misplaced emphasis, timely and adequate access to credit is more important than its cost. The Committee opined that “the pursuit of distributive justice should use the instrumentality of fiscal rather than the credit system.

The Committee therefore suggested:

• the system of directed credit programmes should be gradually phased out making it economically worthwhile for banks to expand their lending to these sectors without determinant to loan quality or bank’s income. This process of phasing out would also recognise the need that for some more time it would be necessary for special credit support through direction to some sectors. The Committee therefore proposed that directed credit programmes should cover a redefined priority sector consisting of the small and marginal farmers also. The credit target for this redefined priority sector should be fixed at 10 per cent of the aggregate bank credit. Credit for agriculture should be on the basis of supervised credit and on a proper techno-economic appraisal of the proposals without any political, administrative or judicial interference in credit decisions. Further to encourage the credit flow to agriculture the Committee suggested the institution of a preferential refinance scheme by RBI.

• a reorganisation of the banking structure which would consist of i) three or four large banks (including SBI) which would become international in character. ii)
eight to ten national banks with a network of branches throughout the country engaged in general or universal banking. iii) local banks whose operations would be generally confined to a specific region, and iv) rural banks including RRBs whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities.

- to abolish the branch licensing with a view that the banking system substantially extended its branch network over rural areas and successfully achieved an increase in banking density.

- to evolve a rural banking structure which could confine effectively the advantages of the local character of RRBs and the financial strength and organisational and managerial skills of the commercial banks. The committee suggested that the sponsor banks should segregate the operations of their rural branches through the formation of one or more subsidiaries depending on the size, administrative convenience and business assessment of each sponsor bank. Each subsidiary should have a compact area of operations. These subsidiaries of the national banks should be treated at par with the RRBs in regard to the cash reserve and statutory liquidity requirements and refinance facilities from NABARD with a view to improving the viability of rural operations. Regarding the merger of RRBs with their sponsor banks the committee left it to the option of the concerned banks.

3.6 Second Generation Banking Reforms and Agricultural Credit:

In India since the formal announcement of the first initiative of financial sector reforms in the union budget of 1991-92 to the second Report of the Narasimham Committee in 1998 a considerable ground has been covered in putting in place a financial system which can meet the requirements of a more competitive and open economy (GoI, 1998). The Committee reviewed the progress of the reforms introduced as per the Report of 1991 and submitted new proposals. The Committee observed that many of the recommendations of the Report of 1991 have been accepted and some implemented with slight modifications from what was recommended. SLR has been brought down to 25 per cent of net demand and time liability (NDTL) as on
22nd October 1997, CRR has been brought down from 15 per cent to less than 10 per cent. Accounting practices have been prescribed in consonance with internationally accepted standards. Asset classification criteria and income recognition norms have been prescribed. Prudential norms have been prescribed for provisioning of various kinds of assets. Capital adequacy requirements have been laid down. Progressive deregulation of interest rates have introduced except for credit to priority sector below Rs. 2 lakhs. Debt Recovering Tribunals (DRTS) established Asset Reconstruction Fund (ARF) setup. The same measures of progress have not been made with regard to structural and systemic aspects of the reform agenda outlined by the Committee on Financial System (CFS), 1991.

The important recommendations of the Narasimham Committee on Banking Sector Reforms of 1998 are the following:

- On directed credit there is a continuing need for banks to extend credit to agriculture especially to small and marginal farmers on commercial considerations and on the basis of credit worthiness. The Committee recommended that given the special needs of the priority sectors the current practice may continue. The Committee proposed that given the importance and needs of employment oriented sectors like food processing and related service activities in agriculture, fisheries, poultry and dairying these sectors should also be covered under the scope of priority sector lending. The Committee noted that mere fixation of targets and sub-targets has not helped to increase the credit flow to agriculture significantly because of inadequate development of infrastructure, poor credit discipline and weak credit delivery system. Action in these areas rather than mere fixation of sub-targets would help to make agricultural credit commercially viable.

- The Committee also recommended that the interest subsidy element in the credit for agriculture (priority sector) should be totally eliminated and even interest rates on loans under Rs. 2 lakhs should be deregulated for scheduled commercial banks as has been done in the case of RRBs and co-operative credit institutions. The Committee believed that it is the timely and adequate availability of credit rather than its costs which is material for the intended beneficiaries. The Committee wished to reiterate the point made by the Khusro
committee and CFS-1991 that the pursuit of the redistribute objective should use the instrumentality of the fiscal rather than the credit system.

- The Committee further believed that the objective should be to reduce the average level of net NPA’s for all banks to below 5 percent by the year 2000 and to 3 per cent by 2002 and for those banks with international presence to reduce to 3 per cent and 0 per cent by these dates and also to make a distinction between client specific and institution specific reasons and general.

- The Committee viewed the relevance in the broad model on the structure of banking and suggested that foreign banks may be allowed to setup branches, subsidiaries or joint ventures in India and should be treated at par with other banks with regard to directed credit which were exempted from the target of agricultural finance. The Committee recommended the needs of the rural segment is given as Quick credit, on an objective basis, at reasonable rates, sensitive to vagaries of nature and a friendly supporting system for encouraging savings and attracting them into the financial mainstream.

- The Committee strongly urged that there should be no option to any scheme of debt waiver in view of its serious and deleterious impact on the culture of credit.

- The Committee recommended the consideration of the debt securitisation concept in agricultural credit.

- The Committee recommended that the RRBs and co-operative banks have to attain a minimum of 8 per cent capital to risk weighted assets over a period of 5 years and further suggested a review of the capital structure of RRBs. The Committee suggested for delaying the co-operative credit institutions with a view to reducing the intermediation cost and thus providing the benefit of cheaper NABARD credit to the ultimate borrowers. Mechanism could be explored to improve the credit delivering mechanism of PACs.

- The supervisory function over rural financial institutions now entrusted with NABARD may continue for the present but over the longer term this should be vested with the Board for Financial Regulation and Supervision (BFS).
• The present duality of control over the co-operative credit institutions by state
governments, RBI/NABARD should be eliminated and all co-operative
banking institutions should come under the discipline of Banking Regulation
Act under the aegis of RBI/NABARD/BFS.

• Banking policy should facilitate the evaluation and growth of micro credit
institutions including LABs (Local Area Banks) which focus on agriculture,
tiny and small scale industries including such specialist institution as may be
promoted by NGOs for meeting the banking needs of the poor. Third-tier banks
should be promoted and strengthened to be autonomous, vibrant effective and
competitive in their operations.

Apart from this, in 1997 RBI set up a high level Committee to suggest
measures for improving the credit delivery system as well as simplifying the
procedures for agricultural credit. The Committee submitted its Report on 21 April
1998. The Committee in its Report has made several suggestions to improve the flow
of credit to the agricultural sector besides identifying the constraints faced by
commercial banks in providing adequate and timely credit to the rural sector (RBI,
1997)\textsuperscript{57}. A summary of the recommendations are listed below:

• All banks should examine their systems and make suitable modifications to
simplify the documentation covering loan agreements.

• While appraising credit proposals attention should be paid to the evaluation of
the income stream of the borrower taking into account the track record of
credibility, capacity as well as technical viability of the proposal. His
repayment capacity should be assessed on the basis of aggregate household
income and to ensure quick disbursal of loans at least 90 per cent of
agricultural loan applications should be decided at the branch level.

• Advocates the building up of an appropriate return oriented liquid savings
product into the loan to provide a cushion during lean periods.

• The Committee advised the system of disbursing agricultural loans partly in
cash and partly in kind may be dispensed with.
• The Committees suggested for the setting up of dedicated recovery teams by the state government and also educate the borrowers through rurally oriented field publicity campaigns.

• Recommended that RBI or any other agency may not prescribe margin, security, unit cost etc., which should be left to the discretion of the lending banker.

• Proposed a substantial modification in the ‘service area approach’ that freedom should be given to the borrowers to choose any branch of a commercial bank for credit requirements and to banks to operate outside their ‘service area’.

• Further recommended to introduce annual composite cash credit limit for all agricultural borrowing families.

• The Committee also advised to discontinue the practice of taking ‘No Dues Certificate’ from borrowers. Designing specific loan products to meet the demands of the borrowers in the non-farm sector i.e., increased non-farm activities with farm activities to supplement their income.

• The Committee pointed out that the agricultural credit portfolios of commercial banks comprise two sets of borrowers. One linked to government subsidy schemes where cases are sponsored by government agencies and sanctioned by banks and the other identified by banks directly. Recoveries in respect of the former are 30 per cent while in respect of the latter are 80 per cent plus. The Committee recommended a systematic review of the subsidy linked lending and favoured replacement by an alternative method of lending without subsidy and on the basis of commercial decision of banks.

• The Committee was in favour of disbanding the target of 18 per cent of outstanding credit for agriculture and suggested that banks can fix self set targets for lending to agriculture which should be based on the flow of credit and special agricultural credit plans.

The Committee further confirmed the general impression in the banking industry that farmers need timely credit with the interest rate being only a supplementary factor. It was argued that even the revised rates charged by co-operatives and RRBs were much below than those charged by the private money
lenders whose role even in agriculturally advanced states such as Punjab is substantially high particularly for loans for short duration such as crop loans.

KCC scheme was implemented in the 1998-99 to further financial inclusion by improving the accessibility of credit by farmers. It was a Government initiated measure intended to overcome the rigidities inherent in the credit system and to make the credit market more borrowers friendly. The scheme aimed to provide adequate, timely credit support to farmers from the banking system in a flexible, hassle free and cost effective manner. The farmers may use the card for the purchase of agricultural inputs and other production needs. Credit limits are fixed on the basis of landholding size, cropping pattern and scale of finance. The KCC scheme has been implemented in all states and union territories by all public sector commercial banks, state co-operative banks/district central co-operative banks and RRBs. By the end of 2010, the number of cards issued has risen to 93,672,827 (RBI, 2010).

The Expert Committee on Rural Credit (Vyas Committee) appointed by NABARD in July 2001 and made recommendation regarding agricultural credit also. The Committee recommended that the mandated rates of 18 per cent of credit outstanding for agricultural loans and 40 per cent for priority sector loans should be reviewed after five years. It projected Indian agriculture to undergo substantial structural and other changes in this period which would be the base for a more realistic reappraisal of credit requirements. It also recommended a substantial reduction in RIDF interest rates to levels just enough to cover the interest cost of deposits. This would make RIDF deposits economically unattractive to banks and spur them to achieve agricultural lending targets, with higher margins to cover transaction costs and provide reasonable profits.

The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (2004), under chairmanship of Prof. Vijay Shankar Vyas recommended that RRBs should continue but should be restructured into viable financial institutions, simultaneously retaining their regional character and rural focus. The alterations initiated in stages would ultimately result in 20 state-level RRBs.

The Government of India, as part of its strategy to boost agriculture production, announced a package to double the flow of institutional credit to agriculture within three years starting 2004-05. Consequently, targets were set and the programme was
implemented during the period 2004-05 to 2006-07. NABARD and RBI were vested with the responsibility of overseeing the implementation of the programme. There were notable inter-agency and an inter-district variation with regard to year of achievement of the doubling of agriculture credit as well as in terms of ‘number of times’ the target was achieved. In all the states, the commercial banks fared better than the RRBs and Co-operatives. At all India level, institutional credit flow through the scheduled commercial banks increased from Rs.25,255.93 crores as at end June 2003 to Rs.1,15,265.86 crores as at the end June 2007, registering a compound annual growth rate CAGR at 47 per cent (NABARD, 2009). During the same period, number of accounts increased from 70.07 lakhs to 155.37 lakhs and registered an annual CAGR of 22.15 per cent. Similarly, average loan per account increased from Rs. 36040 to Rs. 74189 during the period 2003-07. Thus the growth in credit flow between 2003 and 2007 resulted in both credit widening (increased accounts) as well as credit deepening (increased loan per account.) At state level, credit widening and deepening varied substantially. The credit widening was more conspicuous in Maharastra as the annual growth in number of accounts was 40 per cent and the average loan size increased at 10 per cent only. Madhya Pradesh followed similar trend. In remaining three states (Tamil Nadu, Rajasthan and Uttar Pradesh), the growth in credit flow followed the all India trend and contribution of widening and deepening to the credit flow was almost equal. In Uttar Pradesh and Rajasthan, the share of RRBs declined drastically while that of Co-operatives declined in all the states, excepting Rajasthan. The Report has further suggested that there is a need to orient agriculture credit policies in a manner that is more conducive for the marginal and small farmers, tenant farmers, share croppers and oral lessees in accessing credit from formal institutions (Ibid).
References:


11. NCAER (1974), Credit Requirements for Agriculture, New Delhi.


15. Ibid. p. 96.


29. Ibid.


33. Ibid.


49. Ibid.
50. Ibid.
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60. Ibid.