CHAPTER IV

Need for Institutional Financing for Rural Credit in India

❖ Backdrop
❖ Rural Credit Requirements
❖ Sources of Rural Finance
❖ Need for Institutional Finance for Rural Credit
❖ Institutional Arrangements for Rural Credit in India: Pre and Post Independence Era


Backdrop

The Indian economy is predominantly occupied by the agriculture sector and its rural people. The development of Indian economy thus depends upon rural rebuilding to a great extent. Rural rebuilding is a strategy to improve the social and economic life of the people, comprising of small and marginal farmers, tenants, landless labourers and the poorest among those who seek livelihood in rural areas. Rural development and rebuilding can also be defined as a constructive way to improve the quality of life of the rural poor. “Planning without village, in India, are a myth; business without village a bad bargain and service without village, a mockery.” (Bhattacharya, 1986).

Rural development and rebuilding was conceptualized by our great leaders before independence. The idea was concretized by our great leader Gandhiji. The toil, drudgery and sub-human living conditions of the rural people in India were experienced by him. “Having lived it, Gandhiji knew for certain that unless and until the village economy of India was boosted, Swaraj would be meaningless”. (M.K. Gandhi – Harijan – 16th Nov., 1934). Soon after independence, the country found itself with a dilemma, as it were, of rising aspiration of the fellowmen for a accelerated economic development and social progress in one hand and a general inadequacy of the basic ingredients of development, on the other. At that time, our country was characterized by extremely low level of incomes and savings and the absence of well developed capital market and financial institution to mobilize these savings which were available for productive purposes.

The development process of Indian economy were very often sporadically affected by the trauma of drought, floods and similar other natural calamities with entailed famine whose impact on rural masses was severely acute. In fact, to transform the socio-economic life of the fifty percent of those populations living below poverty line in rural areas had assumed greater
significance because of its explosive nature, which was threatening the demographic system of our country (Wadhva, 1980). Thus, it was apprehended that, the redemption of villages from squalor of abject poverty could only be possible either through generation of rewarding employment or through adequate institutional financing for the rural poor people. Rural development and rebuilding process would no doubt, promote development of necessary infrastructure, cottage and small industries as well as secondary and tertiary sector (Arora, 1982). Being an important segment of the tertiary sector, specialised banking system in this specific sector would also act as a backbone of economic progress and prosperity by playing a pervasive role of a catalyst in such development. It was perceived that the banking institutions would act as an instrument for conversion of static credit into dynamic credit (Jha, 1980; Subrahmany, 1982).

**Rural Credit Requirements**

Credit is the fulcrum of an economy's progress. Every sector in an economy needs credit for their day-to-day activities and for its growth and progress. It is the basic requirements for every sector and rural sector is no exception to it. Rural credit is the basic input for any rural development programme. It helps in the progress of any specific problem area or any target group engaged in certain specific economic activity. Rural credit is also regarded as the essential means of an ultimate goal for increasing production and also in generating higher income to the rural poor people.

Since independence, the basic motto of rural credit policy in India, has been in improving the quality of rural life and raising the standard of living of the rural poor. Our country is essentially a rural country and rural India is the cultivator, the village craftsman and the agricultural labourers. The development of the rural sector is the basic requirement for the
realization of this goal since 76 percent of the population of our country has been continuing to reside in this sector (RBI, 2006). However, the non-availability of adequate rural credit is the most serious constraint in rural development. Another major cause of rural poverty is credit from the unscrupulous money lenders who usually charge exorbitant rate of interest and often resort to several questionable practices. The rural poor people (e.g., landless labourers, rural artisans, small and marginal farmers, small entrepreneurs), who lead their lives at subsistence level, need credit from the rural shylock (moneylenders) to survive. As a result they are forced to turn to bonded labourers and permanently trapped into a vicious circle of poverty. Rural credits are generally required for the following:

*Production credit*

Most rural people generally take loan to buy seeds, fertilizer, arrange water, pay wages to workers etc. These recurring farm expenses are related to agricultural operations. Since farmers are mostly living at subsistence level and having no savings, they require advances to carry out productive activities.

*Investment Credit*

The farmers require credit for improvement of farm assets and land through digging wells, fencing the land, clearing marshy areas etc.

*Consumption Credit*

Due to lower income, the rural poor people need consumption credit for meeting their requirements for food grains, clothing and utensils, to meet medical expenses, to repair houses and also to celebrate social and religious ceremonies e.g., birth, marriage and death. These consumption credit are personal and non-farm credit.
**Short-term Credit**

The rural people necessitate short-term credit (having tenure of 15 months) for crop production, purchase of inputs and pledge of warehouse receipts. Usually such loans are repaid after the next harvesting season. Short term credit are used for purchasing seeds, fertilizer, paying wages and rent to the landlord and for meeting transportation costs to carry products to the market.

**Medium-term Credit**

The tenure of this kind of advances is in between 15 months to 60 months. These loans are used for land development, minor irrigation, purchase of farm machinery, animals and other purposes. This sort of credit is also required for purchasing of bullocks or repairing bullock cart or machinery or in digging wells.

**Long-term credit**

Long term credit, having a tenure of 5 years to 25 years are required for purchasing heavy machinery like tractors, additional lands, redemption of debts, construction of well or tank or for setting up of a plantation. Usually, these sorts of loans are repaid in instalments over a number of years.

**Credit requirement for capital expenditure**

These loans are required for acquiring permanent assets or repairing of assets, e.g., purchase of land, houses etc.

**Credit requirements for capital expenditure on non-farm business:**

These loans are required for purchase of houses, furniture, transport etc.

**Credit required for current expenditure**

These loans are needed for carrying out day to day production activities e.g., payment of wages, electricity bills, rent etc.
**Repayment of Debt and Interest credit requirement**

These loans are requested to pay interest on outstanding debt and also to repay debts.

**Credit requirement for family expenditure**

Since most of the rural people are running on deficit budget, so they need credit to meet their day to day family expenses and social and religious purposes e.g., purchase of clothes, medicines, education, entertainment etc.

**Other Expenditure requirements**

Sometimes the rural people need credit to repay premium on insurance of assets, purchase of gold and silver ornaments and shares or bonds.

A pictorial representation of rural credit requirements are shown in **Chart – 4.1** below.

![Chart – 4.1](chart.png)

**Chart – 4.1**

Rural Credit Requirements

<table>
<thead>
<tr>
<th>Nature (RBI Rural Credit Follow-Up Survey)</th>
<th>Period (Co-operative Act)</th>
<th>Purposes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production Investment Consumption credit</td>
<td>Short-period credit</td>
<td>Capital</td>
</tr>
<tr>
<td></td>
<td>Medium-period credit</td>
<td>Current</td>
</tr>
<tr>
<td></td>
<td>Long-period credit</td>
<td>Capital expenditure on non-farm work</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Family expenditure</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Repayment of debt</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Others</td>
</tr>
</tbody>
</table>

A study carried out by the World Bank between 1994 and 1995 (Mahajan et al.)
1996) pointed out the average annual credit usage by rural households based on their credit usage worked out Rs.14,549. Out of this, 65 percent was for productive purposes, 49 percent for short term purposes like agricultural crop and the remaining 16 percent for loan long term productive purpose viz., purchase of livestock, farm machinery, etc. Of the total usage, 35 percent was for consumption purposes – 15 percent being on account of long term purposes like house building, marriage etc., and 20 percent for short term purposes like household expenses, clothes, consumer durables and many others.

Sources of Rural Finance

Public investment for rural development is generally financed through budgetary allocation under the provision for infrastructure and social overhead. However, finance for promoting and expanding activities e.g., agriculture, industry etc., is supported by the households or other private sector economic units, whether rural or urban, through internal and external sources. While current and past savings of the economic units constitute the internal sources, the primary constituent of external sources of fund is borrowings. According to Nurkse (1952), majority of the rural people has very small capacity to save because of low level of income resulting low productivity and ultimately small or no savings. Thus, in absence of requisite owned funds for financing investment and even production activities, rural economic units have to depends mostly on borrowed funds.

The two main sources, from which the peasantry procures credit, are –

(i) institutional sources viz., government, commercial banks, co-operative societies, farmers’ service societies, land development banks, RRBs etc.

(ii) non-institutional sources viz., money-lenders, landlords, relatives, village traders etc.
For rural people, institutional financing to compensate their credit need is more preferable than non-institutional financing because the government, commercial banks or the cooperatives are more solvent and have huge funds at their disposal. Moreover, they strictly abide by the rules and regulations, avoid exploitation of rural folks and introduce for favourable schemes to satisfy various credit needs of the rural people including consumption as well as production needs.

The moneylenders play a predominant role in rural finance. They offer loan for production and consumption purposes as well including social, religious ceremonies and ensure continuous financial help in running their business year after year. With expertise at their disposal, they also cater the need for rural credit in an integrated manner. Sometimes, they provide expert advice to the rural people on agriculture and other related operations (Ghatak, 1976). Inadequate number of rural credit agencies, inherent weaknesses of commercial and co-operative banks and the age-old belief of weak creditworthiness of rural people results the prominence of money lenders in the villages. As these lenders aspired to earn maximum profit the loan provided by them was dearer as compared to institutional credit which was guided by service motive rather than profit motive (ibid). where during 1951-52 the contributions by the institutional agencies was around 90.9 percent of the total credit sources, in 2001-02 it came down sharply to 33.03 percent (detailed shown in Table - 4.1) because of increased participation of the commercial banks and co-operatives.

Need for Institutional Finance for Rural Credit

Not denying the positive role played by the money lenders in the rural economy and their financial, the All India Rural Credit Survey Report (1971-72) aptly pointed out the astute
problem of their virtual monopoly in supplying rural credit. Later on, several other committees, also raised the similar issue (Expert Committee on Consumption Credit or Sivaraman

Table - 4.1.

Percentage Distribution of Rural Credit by Source 1951-52 to 2001-02.

<table>
<thead>
<tr>
<th>Agencies/ Institutions</th>
<th>Proportion in Total Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Government</td>
<td>3.3</td>
</tr>
<tr>
<td>2. Commercial Banks</td>
<td>0.9</td>
</tr>
<tr>
<td>3. Co-operatives</td>
<td>3.1</td>
</tr>
<tr>
<td>INSTITUTIONAL</td>
<td></td>
</tr>
<tr>
<td>AGENCIES (1+2+3)</td>
<td></td>
</tr>
<tr>
<td>4. Landlords</td>
<td>1.5</td>
</tr>
<tr>
<td>5. Agricultural Moneylenders</td>
<td>24.9</td>
</tr>
<tr>
<td>6. Professional Moneylenders</td>
<td>44.8</td>
</tr>
<tr>
<td>7. Traders and Commercial Agent</td>
<td>5.5</td>
</tr>
<tr>
<td>8. Relatives</td>
<td>14.2</td>
</tr>
<tr>
<td>9. Others</td>
<td>1.8</td>
</tr>
<tr>
<td>NON-INSTITUTIONAL SOURCES (B)</td>
<td>92.7</td>
</tr>
<tr>
<td>TOTAL (A + B)</td>
<td>100.00</td>
</tr>
</tbody>
</table>


Committee 1976, Craficard 1981). The rate of interest charged by them was quite high, often much above the maximum rate legally prescribed by the state governments. Due to the 'helplessness, ignorance and necessity of the borrower', the private money lenders often resorted to several questionable practices. These practices included – (a) taking of thumb impression on a blank paper with a view to inserting any arbitrary amount at a later date if the debtor became irregular in payment of interest on outstanding loan amount, (b) insertion in written document of any sum in excess of the actual money lent, (c) general manipulation of account to the
disadvantage of the debtor, (d) demand for advance rent, (e) demand for a present for doing successful business, known as girah kholai (purse opening), (f) taking of conditional sale deeds in order to provide against possible evasion of payment by the debtor. Rural poor were also exploited through advance contracts for attached sale of output only through the moneylenders resulting in a sale price lower than what the borrower would have obtained had he tried to sell his output directly into the market. The private money lenders exercised several other measures to exploit the poor rural folk of Indian villages. These exploitations were mostly rooted in the socio economic environment prevailing in the villages. As Ghatak pointed out, the social force took the form of ‘loss of face or local prestige’, caste disapproval or pressure through self governing bodies i.e., panchayats 1. Several scholars, mainly sociologists (e.g., Gough, 1955), investigated the various forms of socio-economic controls exercised by the private money lenders over the rural poor in the villages. According to them, many coercive measures were used by the unscrupulous money lenders towards the poor borrowers especially those belonging to the lower castes in the Indian villages to extract dues e.g., payment of fines for temple funds operated by the high caste Brahmins 2 and at the extreme, eviction of those peasants from their lands. Thus, in the vicious circle of poverty the poor villagers were permanently entrapped into the clutches of the money lenders. They were forced to borrow from those rural shylocks to meet their consumption need and most certainly for special occasions to keep up with social traditions of the group or caste to which

1. The Panchayat is a South Asian Political system. 'Panchayat' literally means assembly (yat) of five (panch) wise and respected elders chosen and accepted by the villages community. Traditionally, these assemblies settled disputes between individuals and villages. Panchayat also refers to a council of elected members taking decisions on issues key to a village's social, cultural and economic life: thus, a panchayat is also a village's body of elected representatives. The council leader is named sarpanch in Hindi, and each member is a panch. The panchayat acts as a conduit between the local government and the people. (http://www.google.co.in. Accessed on 30.07.2008)

2. Brahmin, in Hinduism, traditionally refers to the priestly caste or a member of this caste in the Hindu caste system. According to Hindu Dharma, it is the highest caste among the four varnas of Hindu religion. The Sanskrit word Brahmana denotes the poet/scholar/teacher, priest, caste, class (varna), or tribe, that Hindu tradition enjoins to live a life of learning, teaching and non-possession. The English word Brahmin is an anglicized form of the Sanskrit word brahmana, however they are not necessarily the same things. The history of Brahmin community in India begins with the Vedic religion of early Hinduism, now often referred to by Hindus as Sanatana Dharma, in ancient India. (http://www.google.co.in. Accessed on 30.07.2008)
they belonged (e.g., marriage or birth or death in the family or celebration of a favourable court
verdict or festivals etc.) and even to buy seeds etc., during sowing times. Any natural calamity or
accident almost invariably pushed these helpless rural borrowers to the door of the moneylenders.
Thus, due to imperfection in the rural economy, non-institutional agencies took an active part in
satisfying the rural financial need. At the end of March, 2000, this section provided almost
33 percent of the total demand of rural credit in India (Nanda, 2000). Under such circumstances,
rural credit structure remained static within the vast majority of the country. The major problem,
as was felt, therefore to overcome this static situation and convert into some dynamic credit state.

Regarding the role of banking institutions, as development agencies, there were
three different schools of thought (Goyal, 1987). According to some, there was a view that banking
institutions should take a pervasive developmental role for rural development. The other view was
banking institutions, being primary credit agencies were not expected to take such role and their
function should be restricted to make credit available to the bankable projects. The third view was
referred to the developmental responsibility of banking institutions to take cognizance of the
complimentary role played by other agencies. This presumed to be the golden means as credit was
regarded as the catalyst to any development process, but could not bring any development by
itself.

In this sense, banking institutions are considered as parameters in development
with other agencies. At the same time, they should not only restrict themselves as observers, but
take active role in initiating such activities wherever they are not already in operation. As for
example banking institutions, when financing a dairy development scheme can use its good offices
to organize fodder supplies, marketing societies, chilling facilities etc., by extending credit for
such purposes. In this way a banking institution can not only contribute to development but also
pave the way for the successful recovery of its loan. Thus the initial impulses for generating a
development motive can be produced by credit agencies through appropriate marketing of their
credit services.

In most of the developing countries, banking institutions have done considerably
well in growth of their economy. Gerschenkron’s (1962) study has pointed out the importance of
the banking system in the development of European economy. The importance of banking
institutions in promoting rural development in India came into reckoning when rural development
was given the priority during the Five-Year plans, more specifically in the fifth and sixth plan.
Rural Financial Institutions (RFIs) helped the development process in rural areas through
influencing both savings and investments of the rural people. The banking sector, by attracting the
savings of the community, mobilised the deposits of the various maturity and liquidity and
extended the resources by way of loans for agriculture, industry, transport, commerce and allied
activities as well as to the government for various development purposes. Thus, the banking
institutions, on one hand, increased the savings and on the other hand strengthened the hands of
the rural investors on the other.

Institutional Arrangements for Rural Credit in India: Pre and Post Independence Era

The story of institutional financing for rural development in India was noted in
various experiments with different field studies of rural finance. In India, there was money lending
since the early days of civilization. During the Vedic period 3 money lending was the side business
of Vaishyas 4. The phenomenon of lending and borrowing was recorded in Vedas. In the Vedic

3. The Vedic period (or vedic age) is the period in the history of India during which the Vedas, the oldest sacred texts of Hinduism,
were being composed. Scholars place the Vedic period in the second and first millennia BCE continuing up to the 6th century BCE
4. The Hindu varna (class) system, a Vaishya is a member of the third of the four classes of traditional Indian society. It comprises
literature, ‘rua’ or ‘debt’ was repeatedly mentioned. The *Atharvaveda* 5 enjoined “Dhanen deva Dhanami – chhamanah”, this was commented by Sri Sayanacharyaj as “Hae Deva Dhanen mulya dhanen bridhiuktam dhanen ichhamanah kamamansham”, which when translated read as “O god, I engage myself in money lending from my sum (principal sum) in order to earn money (principal added with interest)”. The activities of borrowing and lending were also mentioned in Rigveda 6 (Nigam, 1967). At the earlier stage, loans were granted to the cultivator from the royal treasury. This loan was called as ‘*Taccavi loan*’ 7. About the loan granted from royal treasury in the mughal period, *Ain-i-Akbari* 8 described the following – earlier to Akbar 9, the greatest mohammaden ruler, every musalman king considered India to be a ‘land of infidel’ (dar-ul–harb) and money lending was a greatest sin. Akbar, however changed and modified this outlook. Under his regime, every collecting officer, considered himself as the immediate friend of the husbandman and to assist him to transact his business smoothly. As a representative of the chief magistrate, he would assist the needy husbandman with loans and recover payment at district and at convenient period (Joshi, 1978).

In the British period, the ‘*Taccavi loan*’ was controlled by the Land Improvement Act, 1883 and Agriculture Loans Act, 1884 (Wadhva, 1980). It was the main governmental

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5. The *Atharvaveda* is a sacred text of Hinduism, and one of the four Vedas, often called the “fourth Veda”. According to tradition, the Atharvaveda was mainly composed by two groups of rishis known as the Atharvanas and the Angirasas. ([http://www.google.co.in. Accessed on 30.07.2008](http://www.google.co.in))

6. The *Rigveda* is an ancient Indian sacred collection of Vedic Sanskrit hymns dedicated to the gods. It is counted among the four canonical sacred texts of Hindus known as the Vedas. Some of its verses are still recited as Hindu prayers, at religious functions and other occasions, putting it among the world’s oldest religious texts in continued use ([http://www.google.co.in. Accessed on 30.07.2008](http://www.google.co.in))

7. Muhammad ibn Tughluq, the first Indian ruler recorded in history to advance loan (Taccavi loan) to the villagers following disastrous famine in Bengal (Ref. Society and State under the Tughluqs [http://www.google.co.in. Accessed on 30.07.2008](http://www.google.co.in))

8. The *Ain-i-Akbari* or the “Institutes of Akbar” is a detailed document recording the administration of emperor Akbar's empire, written by his vizier, Abu'l-Fazl ibn Mubarak. It makes the Volume III and the final part of the much larger document, the Akbarnama, the book of Akbar, also by Abul Fazl, and it itself is in three volumes ([http://www.google.co.in. Accessed on 30.07.2008](http://www.google.co.in))

9. Jalaluddin Muhammad Akbar also known as Akbar the Great (October 15, 1542 – October 17 or October 27, 1605) was the son of Nasiruddin Humayun whom he succeeded as ruler of the Mughal Empire from 1556 to 1605. he was the grandson of Babur, who founded the Mughal dynasty. On the eve of his death in 1605, the Mughal Empire spanned almost 500 million acres (doubling during Akbar’s reign) ([http://www.google.co.in. Accessed on 30.07.2008](http://www.google.co.in))
instrument utilized for the promotion of rural development. But it failed to reap the benefits due to rigidity in the rules and regulations and indifferent attitude of the bureaucrats. Moreover the small and marginal farmers, artisans and also other rural people were less informed about this financial help for rural development. Since 1904, co-operative movement was encouraged in developing the rural economy of India. After independence, the Government of India initiated different Five Year plans for achieving accelerated and diversified growth of the rural sector. In the first Five Year Plan, the importance of agriculture and rural credit was realized by the planners and the need for building up a sound formal credit system was stressed for achieving the developmental goals. The plan laid down target coverage of 50 percent of the villages and 30 percent of the population under the cooperative credit system within the next ten years. The involvement of the RBI in institutionalizing operations of cooperative credit in terms of guidance, concessional resources and training was enlarged further and the partnership of the state governments in the cooperative credit institution became an important feature. The objective of rural credit policy since 1951, was being in broadening up the role of institutional agencies and to consequently reducing subsequently the role of non-institutional credit agencies, especially the private moneylenders. Bengal Chamber of Commerce, Kolkata was the first to draw the attention of the Government towards the need for growth of the rural banking and presented the first ever plan for the establishment of rural banks in the country (Joshi, 1980). The plan, however, could not muster the necessary support and was consequently shelved. The key role of coordinating the intensive effort was assigned to RBI who introduced two funds viz., the National Agricultural Credit fund meant to provide long term funds to state partnership in cooperatives and subscription to the debentures of the Land Mortgage Banks and the National Agriculture Credit (stabilization) fund to facilitate conversion of short term cooperative loans issued by the cooperatives during the period of natural calamities into
medium term loans as constituted in the RBI. In 1951, RBI set up the All India Rural Credit Survey Committee which recommended an integral scheme of reorganizing the cooperative credit structure. Considering the strengths and weaknesses of the rural credit system dominated by the non-institutional credit suppliers, the Committee (1951-52) recommended in favour of organizing multi-facet cooperatives, providing integrated credit facilities, linking production with marketing of inputs and outputs, processing and warehousing activities and providing viable alternatives in solving the credit problems of the Indian rural people.

The Government accepted the recommendations of the Committee and provided its active support through the state governments and RBI to constitute a comprehensive cooperative credit structure based on a three-tier system consisting of state cooperative banks or SCBs as an apex body at the state level, an intermediary layer of district central cooperative banks (DCCBs or simply CCBs at the district level) and the primary credit societies at the base (or retail or village) level. The 'primaries' are further divided into primary agricultural credit societies (PACSs) and primary non-agricultural societies. PACS could be further segregated into 'small-sized agricultural credit societies' and 'large sized agricultural credit societies'. Within this cooperative structure for rural credit, a clear distinction was made between two types of cooperative agencies, namely, cooperative credit agencies which would provide short and medium term loans and land development banks or LDBs which would specialize in providing only medium and long term loans for agricultural development.

The National Commission on Agriculture (1962) had strongly advocated the concept of the formation of farmers service societies or FSSs at the base level as the new cooperative society, formed out of group of cooperative societies, which would provide an integrated package of service to the farmers including the supply of inputs and facilities for
marketing of the produce. Thus, a number of FSSs were also started to operate on the rural credit landscape.

Commercial banks in India had been usually lending a negligible proportion of their funds to the rural areas. Considering the vast gap that existed in meeting the credit needs of modern agriculture in the framework of a planned developing economy and the desire to increase the role of the institutional credit agencies, the government accepted the idea of multi-agency approach to the development of credit institutions which was recommended by the All India Rural Credit Review Committee (Venkatappiah Committee, 1969). The National Credit Committee Study Group on organizational framework for the implementation of social objective (Gadgil, 1968) recommended that the main aim of the future national credit policy should be on involving the commercial banks in providing rural credit.

However, the All India Rural Credit Review Committee recognized that commercial banks being essentially urban in origin, they did not process the organizational machinery of the cooperatives to deal with the rural producers and also any organic link with the rural institutions or the opportunity to take help of official machinery in the villages. The committee had, however, wished that progressive and far sighted banks would boldly enter into rural areas for providing services of banking and credit. With such divergent views from different committees, it was not surprising when the banking committee (Saraiya) in 1972 recommended that frequent changing of the organizational pattern of rural credit was undesirable. The commercial banks came into the Indian rural credit scheme in a big way through their nationalization in 1969. Its main objective was extension of credit coverage to the rural poor which had been neglected by the banking system. This was attempted through a massive programme of rural branch expansion and also by introducing the ‘priority’ sector concept. It was
stipulated that at least 40 percent of the bank’s lending should be to priority sector and ten percent to the weaker sections.

The next attempt by the Government was made in 1970 to link the co-operatives at the grass root level and the commercial banks mainly with the objective of supplementing the lendable resources of the former through this additional channel of supply of funds. This was perceived necessary in view of the fact that most of the PACSs and DCCBs had heavy overdue and had become ineligible for a further grant of refinancing under the guidelines for credit to co-operatives enforced by the Reserve Bank of India. Another way in which the link between commercial banks and potentially linked viable PACS was sought to be fostered was by encouraging the commercial banks to take initiatives in the establishment of the farmer service societies (FSSs).

There was further development when the RRBs were established in 1975 to provide low cost banking services to the rural poor. On establishment of new institution of RRBs, the institutional agencies providing rural credit, purpose-wise, could be classified as – (i) primary agricultural credit societies, (ii) concerned government department(s) and, (iii) scheduled commercial banks providing direct finance to rural borrowers for short-term and medium-term purposes. Usually medium-term and/or long term loans were provided by the primary agricultural societies, land development banks and scheduled commercial banks. In addition, indirect finance to rural borrowers through primary cooperatives and other local bodies for short-term purposes was provided by the state cooperative banks and scheduled commercial banks while indirect finance for medium and/or long-term purposes were financed by the scheduled commercial banks, central land development banks (operating at the state level) and the Rural Electrification Corporation. RBI played a major developmental role in refinancing to agriculture through existing
institutional sources of rural credit. Another main initiative in strengthening the institutional framework for purveying rural credit was the setting up of National Bank for Agriculture and Rural Development (NABARD) in 1982 as an apex institution, supported by RBI and GOI. A detail of the institutional rural credit rural credit structure of India is given below (Chart – 4.2).

Within the framework of multi-agency approach, RRBs are also playing a significant role since their inception. It is evident (Table - 4.1) that out of total loans (both direct and indirect) issued for agriculture and allied activities by the RFIs along with the respective state governments, individual share of RRBs had been improved from Rs.343.3 crore to Rs.6,481 crore (2.68percent to 6.92percent) during the period 1990-91 to 2004-05. The significant contributions of RRBs in India are discussed in detail in the subsequent chapter.
Chart 4.2.

Rural Credit Structure (Institutional) in India

Reserve Bank ---------------------------------- Government of India (RBI)

<table>
<thead>
<tr>
<th>National Bank for Agriculture and Rural Development (NABARD)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Co operative Banks</th>
<th>Commercial Banks</th>
<th>Regional Rural Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short term Structure</td>
<td>Long term structure</td>
<td>Metropolitan Branches</td>
</tr>
<tr>
<td>SCBs</td>
<td>SLDBs</td>
<td>Urban Branches</td>
</tr>
<tr>
<td>DCCBs</td>
<td>Branches</td>
<td>PLDBs</td>
</tr>
<tr>
<td>PACSs</td>
<td>Branches</td>
<td>Rural Branches</td>
</tr>
</tbody>
</table>

Abbreviation: SCBs – State Co operative Banks; DCCBs – District Central Co operative Banks; PACSs – Primary Agriculture Credit Societies; SLDBs – State land Development Banks; PLDBs – Primary Land Development Banks;

### Table 4.1

Direct and Indirect Institutional Credit for Agriculture and Allied Activities (both short term & Long term)  

<table>
<thead>
<tr>
<th>Year / Rural Financial Institutions</th>
<th>Co-operatives</th>
<th>Scheduled Commercial Bank</th>
<th>RRBs</th>
<th>State Governments</th>
<th>REC</th>
<th>Total</th>
</tr>
</thead>
<tbody>
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**Source:** Report on Trend and Progress of Indian Economy, March, 2006, Reserve Bank of India, Mumbai.