Chapter 1

Introduction
CHAPTER-1
INTRODUCTION

1.1 Background

Agriculture, in most of the developing countries, is an important sector providing livelihood to a significant proportion of the population, especially in rural areas. India, being a developing economy, recognises the importance of agriculture in the process of economic development. It provides livelihood to around 60 per cent of the total population and generates employment for about 58.2 per cent of the country’s work force. The sector has contributed 14.6 per cent to the gross domestic product in the financial year of 2009-10.

The introduction of modern technology to agricultural sector during the latter half of 1960s (Green Revolution era)\(^1\) in India has made a remarkable increase in food grains production. The production has increased from 72.35 million tonnes in 1965-66 to 176.4 million tonnes in 1990-91, which further increased to 218.1 million tonnes in 2009-10. This tremendous growth was made possible by the adoption of high yielding varieties of seeds particularly wheat and rice crops, expansion in irrigation facilities, higher use of modern inputs (like fertilizers, pesticides, etc.), expansion of agricultural market infrastructure, regulation of minimum support price policy, development of infrastructure and institutions like power, village roads and institutional agricultural credit.

Although the use of modern techniques has made India a self-sufficient country in the area of food grain production, the condition of majority of farmers deteriorated. This is because about 80 per cent of Indian farmers are small and marginal with low levels of income. Hence, inability to save and invest in modern technology due to low level of income brings them to low level of agricultural production.

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\(^1\) The introduction of high-yielding varieties of seeds and the increased use of chemical fertilizers and irrigation are known collectively as the Green Revolution, which provided the increase in production needed to make India self-sufficient in food grains, thus improving agriculture in India. High-yielding wheat was first introduced to India in 1968 by American agronomist Norman Borlaug. Borlaug has been hailed as the “Father of the Green Revolution” but M.S. Swaminathan is known as the “Father of the Green Revolution in India”.
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. Agricultural credit which is one of the essential inputs in agricultural production helps in creating environment for the adoption of modern production technology and encouraging private investments on the farms. It is also helpful for changing the composition and distribution of production in favour of deficit producers. Improved access to formal credit is supposed to shift rural borrowings from informal market to formal institutions, increasing the use of improved inputs and technology, leading to increased production and higher income for the rural poor. (Donald, 1976; George, et al., 1985; Sidhu and Gill, 2006).

In India, the problem of adequate and cheap credit is one of the perpetual problems of Indian agriculture. To overcome this problems and to provide protection to those farmers who rely highly on informal sources of finance like moneylenders, landlords and traders etc. who exploit them by charging unreasonably high rate of interest, Indian government emphasized on adequate and timely supply of institutional credit to farmers. The following table shows the relative share of borrowing of cultivator households from different sources.

**Table 1.1: Relative Share of Borrowing of Cultivator Households from Different Sources**

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Institutional Agencies</td>
<td>7.2</td>
<td>14.8</td>
<td>29.2</td>
<td>61.2</td>
<td>64.0</td>
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</tr>
<tr>
<td>Government</td>
<td>3.3</td>
<td>5.3</td>
<td>6.7</td>
<td>4.0</td>
<td>5.7</td>
<td>2.3</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>3.1</td>
<td>9.1</td>
<td>20.1</td>
<td>28.6</td>
<td>18.6</td>
<td>27.3</td>
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<td>Commercial Banks (including RRBs)</td>
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<td>0.4</td>
<td>2.2</td>
<td>28.0</td>
<td>29.0</td>
<td>24.5</td>
</tr>
<tr>
<td>Others institutional agencies*</td>
<td></td>
<td>0.2</td>
<td>0.6</td>
<td>10.7</td>
<td>3.0</td>
<td></td>
</tr>
<tr>
<td>Non-Institutional Agencies</td>
<td>92.8</td>
<td>85.2</td>
<td>70.8</td>
<td>38.8</td>
<td>36.0</td>
<td>42.9</td>
</tr>
<tr>
<td>Landlord</td>
<td>1.5</td>
<td>0.9</td>
<td>8.6</td>
<td>4.0</td>
<td>4.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Agricultural Moneylender</td>
<td>24.9</td>
<td>45.9</td>
<td>23.1</td>
<td>8.6</td>
<td>6.3</td>
<td>10.0</td>
</tr>
<tr>
<td>Professional Moneylender</td>
<td>44.8</td>
<td>14.9</td>
<td>13.8</td>
<td>8.3</td>
<td>9.4</td>
<td>19.6</td>
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<td>Traders and Commission Agents</td>
<td>5.5</td>
<td>7.7</td>
<td>8.7</td>
<td>3.4</td>
<td>7.1</td>
<td>2.6</td>
</tr>
<tr>
<td>Relatives and Friends</td>
<td>14.2</td>
<td>6.8</td>
<td>13.8</td>
<td>9.0</td>
<td>6.7</td>
<td>7.1</td>
</tr>
<tr>
<td>Others</td>
<td>1.9</td>
<td>8.9</td>
<td>2.8</td>
<td>4.9</td>
<td>2.5</td>
<td>2.6</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

*Note: * includes insurance, provident fund, financial corporations/institutions, financial companies and other institutional agencies.

*Source: Discussion Paper prepared by Dept. of Banking Operations and Development (DBOD) and Dept. of Economic and Policy Research (DEPR), 2013, Reserve Bank of India.*
Available data in Table 1.1 indicates that the institutional finance to rural areas have not displaced non-institutional sources of credit in the recent time. Though the share of total institutional credit to the total increased from 7.2 per cent in 1951 to 29.2 per cent in 1971 which further increased to 64.0 per cent in 1991, it fell to 57.1 per cent in 2002. As a consequence, the share of total non-institutional credit to the total credit decreased from 92.8 per cent in 1951 to 70.8 per cent in 1971 which further decreased to 36.0 per cent in 1991 and after that it increased to 42.9 per cent in 2002.

Several initiatives have been taken in this regard since independence. Some major landmarks in rural credit are the acceptance of All India Rural credit Survey Committee Report (AIRCS)\(^2\) in 1954, introduction of social control over banks\(^3\) in 1967, nationalisation of 20 major commercial banks in 1969 and 1980, establishment of Regional Rural Banks (RRBs) in 1975, setting up of National Bank for Agriculture and Rural Development (NABARD) in 1982, and reforms in the financial sector since 1991. Simultaneously, several measures like establishment of Lead Bank Scheme, Direct lending for the Priority sectors, Banking sectors Linkage with the Government sponsored programmes targeted at the poor, Differential Rate of interest (DRI) Scheme\(^4\), the Service Area Approach (SSA)\(^5\), the Self Help Group (SHGs)-Bank Linkage programme since 1992, Kisan Credit Card Scheme (KCC)since 1998-99, formulation of the Special Agricultural Credit Plans by the public sector banks since 2004-05, and target to double the flow of institutional agricultural credit in 2005-07 by all financial institutions. Several committees/working groups/task forces have been constituted to suggest ways to increase the availability of institutional credit to the agriculture sector.

\(^2\) The All India Rural Credit Survey (AIRCS) Report was released in 1954 by the Gorwala Committee, appointed by the Reserve Bank of India, which undertook a comprehensive survey of rural credit.

\(^3\) The Government of India introduced the scheme of Social Control over commercial banks in the early of 1968. Under this scheme the banks were expected to diversify bank credit more widely and extend to priority sectors like agriculture and small scale industry. This brought the commercial banks in the field of agricultural credit.

\(^4\) Under the Differential Rate of Interest Scheme, introduced in 1972, public sector banks are required to fulfill the target of lending of at least one per cent of the total advances as at the end of the preceding year to the weakest of the weak sections of the society at an interest rate of four per cent per annum.

\(^5\) Service Area Approach was introduced in April 1989 under which each semi-urban and rural branch of commercial banks was assigned a specific area comprising a cluster of villages within which it would operate, adopting a planned approach for its development. The rationale of this approach was to avoid wider areas.
1.2 Evolution of Institutional Finance to Agriculture sector in India

The first action taken by the government for providing agricultural credit directly to the farmers could be traced back to the late 19th century in India under the British Government. The agricultural credit which was provided from the government was called ‘taccavi’. This credit was given under the Land Development Loans Act of 1883 for long-term loans, and the Agriculturist Loan Act of 1884 for short and medium-term loans. Under the former, long term loans were given for undertaking land improvement measures like construction of wells or building of embankments, tanks, water-courses, preparation of land for irrigation, protection of land from flood or erosion. Such loans were generally advanced for periods extending over 25 years on the security of landed property. Under the latter, short and medium-term loans were provided for the purchase of seeds, cattle, manure, implements and the purchase of houses to replace those destroyed by flood. Such loans were repayable after the harvest (Rathore, 1994).

Institutional credit system for the agriculture sector in India was started with the organisation of co-operative credit societies at the beginning of the 20th century. It was set up in 1904 under the Cooperative Credit Societies Act with basic objective to eradicate local money lenders who usually exploit the farmers by charging unreasonable rates of interest which made them indebted and poor. It emphasises thrift and mutual help and to provide cheap credit to the farmers. But the real beginning of cooperative movement was made from the year 1912 when the defects of Act of 1904 were removed through the Cooperative Societies Act, 1912.

The Maclagen Committee (1915) recommended a three-tier cooperative credit structure in every province with Primary Agricultural Credit Societies (PACS) at the village level (grass root level); District Central Co-operative Banks (DCCBs) at District/Intermediary level and State Co-operative Banks (StCBs) at state level to provide crop and other working capital loans to farmers and rural artisans primarily for short and medium-term purposes.

The setting up of the Reserve Bank of India (RBI) in 1934 was a major development in the thrust for agricultural credit. Specific provisions were made in the Reserve Bank of India Act, 1934 both for the establishment of an Agricultural Credit Department (ACD) in the bank and for extending refinance facilities to the
cooperative credit system. Emphasis was laid on setting up, strengthening and promoting financially viable provincial cooperative banks, central cooperative banks, marketing societies and primary agricultural credit societies in each province.

The long-term credit was for the first time established at Jhind in Punjab with the name of Land Mortgage Bank in 1920, followed by organisation of similar banks in Madras in 1925 and Bombay in 1929. These banks extended credit on the security of mortgages and raise funds on its basis by issuing debentures which are fully guaranteed by the state governments. Initially, it aimed at helping the farming community getting out of the clutches of moneylenders but later on it started to purvey production credit for acquisition of farm assets.

A three-tier system of agricultural cooperative credit came into existence in India by 1944. These credit institutions, based on the nature of their lending operations, have typically been divided into two distinct parts, commonly known as the short-term co-operative credit structure which comprises PACS, DCCBs and StCBs and the long-term co-operative credit structure which includes State Co-operative Agricultural and Rural Development Banks (SCARDBs) at the State level and the Primary Co-operative Agricultural and Rural Development Banks (PCARDBs) at the district or block level, provide typically long-term loans for making investments in agriculture, rural industries etc. However, the structure of rural co-operative banks is not uniform across all the states of the country. Some states have a unitary structure with the state level banks operating through their own branches, while others have a mixed structure incorporating both unitary and federal systems. In this way the cooperative credit structure in the country has two wings, one chiefly supplying the short and medium-term credit requirements and the other, long-term investment credit.

The All India Rural Credit Survey (AIRCS), 1954, while analysing the role of taccavi loans, described it as "ill-suited disbursement of inadequate moneys through an ill-suited agency". The committee further observed that the record of taccavi was a record of inadequacies of amount, inconvenience of timing and incidental delays, inefficiency of supervision and incompleteness of co-ordination. It was observed that except in times of famines, floods and draughts these loans cannot be considered as a major source of credit for the cultivators (Tomar, 1974; Mohideen, 1991). Due to these reasons, the moneylender who was an expert in knowledge of crops, climate,
soil, etc. and condition of the borrower came forward and provided sufficient and timely credit to the farmers for agricultural operations. They even facilitated credit easily for unproductive expenditure on various religious and social ceremonies with usurious rate of interest. The usurious rates of interest charged by them, coupled with the unproductive use of the borrowed funds, made the debt burden heavy which became chronic not because of borrowing but because of failure to repay owing to the unproductive use of the funds borrowed (Naidu, 1968). On the other side, due to high dependency on monsoon some productive expenditure by the farmers also faces the risk of unpredictable production of crops which lead to rural indebtedness. This proved that the "Indian peasant is born in debt, lives in debt and dies in debt" (Darling, 1925).

Naidu observed that co-operative credit societies were the best instrument for supplying credit to the multitude of small farmers during the early half of the 20th century with the exception of some financing by the commercial banks and taccavi loans by the government. He further pointed out that the co-operative credit societies not only reduces the cost of credit but also teaches the habits of thrift, punctuality and prudence in its use (Naidu, 1968). In this context the Royal Commission on Agriculture in India, 1926 has observed that "if cooperation fails, there will fail the best hope of rural India".

On the recommendations of the AIRCS, the Imperial Bank of India was converted into State Bank of India (SBI) in July 1955. Its main objective was to reorient it to rural banking and rural finance. The commercial banks came into the realm of agriculture credit in 1969, after the recommendation of All India Rural Credit Review Committee (AIRCRC)6. The Committee observed that:

"At the same time, effort in the sphere of rural credit should not be solely concentrated in the co-operative sector. Co-operatives should be strengthened, but they would be the entire better-and the farmer better served- if other institutions co-existed with them in healthy competition."

Commercial banks were, therefore, inducted into the field of agricultural credit under the policy of Social Control over banks in 1968. Under this scheme the banks were expected to diversify bank credit more widely and extend credit to priority

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6 The All India Rural Credit Review Committee was set up by RBI in 1969 under the chairmanship of B. Venkatappiah to suggest measures for the adequate and timely supply of agricultural credit through co-operatives and commercial banks.
sectors like agriculture and small scale industry. As the objectives of social control over commercial banks, 14 major commercial banks were nationalised in July 19, 1969\(^7\), having deposits of ₹ 50 crore and above. The main aim of nationalisation was to force the pace of expansion of commercial bank branches in rural areas and to augment the flow of bank credit through rural branches to agriculture and weaker sections of society (Reddy, 1990). Commercial banks which were following urban-centred lending policy were to involve themselves in the process of rural development through their lending to the priority sector. This led to the opening of new offices in the previously unbanked areas and also increases in rural lending. This approach which has come to be known as the “multi-agency approach” provides for commercial banks serving as an additional source of credit to the rural sector.

After nationalisation, lending to priority sectors became an essential component of bank lending. In this way the description of the priority sector was formalised in 1972 on the basis of the report submitted by the “Informal Study Group on Statistics Relating to Advances to the Priority Sectors” constituted by Reserve Bank of India in May 1971. The Report prescribed a modified return for reporting priority sector advances and certain guidelines were issued in this connection indicating the scope of the items to be included under the various categories of priority sector. Although initially there was no specific target fixed in respect of priority sector lending. In November 1974 the banks were advised to raise the share of these sectors in their aggregate advances to the level of 33 1/3 per cent by March 1979.

Despite the tremendous growth of the cooperatives and the commercial banks as purveyors of rural credit, need was still felt for specialized financial institutions to cater to the needs of the weaker sections of rural society and to supplement the work of commercial and cooperative banks. On this ground, the Narasimham Committee (1975) came to the conclusion that the regional and functional gaps in the rural credit cannot be met within a reasonable period by reorganising or restructuring the cooperative and commercial bank system. So the committee recommended the setting up of state sponsored region based rural oriented commercial banks which came to be known as Regional Rural Banks (RRBs) and were established in 1975. The intention for setting up of RRBs was to create an institution combining the knowledge of rural

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\(^7\) Six more banks were nationalised in April 1980, having a deposits of ₹ 200 crore and above.
problems which co-operatives possessed and the degree of business organisation and modernisation outlook which the commercial banks had (Singh, 2000). These banks were also scheduled commercial banks (SCBs) supported by the government but sponsored by the commercial banks. They were located in district headquarters with branches within the district. Some of them serve more than one district. They were introduced to lend exclusively to landless labourers, marginal farmers, small farmers and artisans, though they can mobilize deposits from all. These banks provide institutional credit to the weaker sections of the society at concessional rate of interest. Initially, five RRBs started working from October 2, 1975 in four states, two in Uttar Pradesh, one in Haryana, one in Rajasthan and one in West Bengal.

In March 1979 the RBI, in consultation with the Government of India, set-up a Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) under the Chairmanship of Sri B. Shivraman. The Committee in its interim report recommended the setting up of a National Bank, to be known as National Bank for Agriculture and Rural Development (NABARD) to give undivided attention to providing all kinds of production and investment credit to agriculture, small scale industries, village artisans, cottage and village industries, handicrafts and other economic activities in an integrated manner.

The NABARD was set up by merging the Agricultural Refinance and Development Corporation (an apex institution providing refinance and infrastructural support to commercial and cooperative banks) with the Agriculture Credit Department of the RBI which was previously directing the agriculture credit policy and providing refinance support to the rural banks. The NABARD started functioning from July 12, 1982.

In March 1980, all domestic SCBs were advised to raise the proportion of the priority sector advances from 33 1/3 per cent to 40 per cent of aggregate advances by March 1985. The recommendations made by the ‘Working Group on the Role of Banks in Implementation of New 20-Point Programme’ (Chairman: Ghosh, 1982) for the classification of the various segments that comprise the priority sector were accepted and instructions were issued to banks by the Government of India and RBI in February 1983. The various segments which were classified by the above Group’s report under priority sector were Agriculture (both direct and indirect finance), Small Scale Industries, Small Road and Water Transport Operators, Retail Trade, Small
Business, Professional and Self Employed Persons, State sponsored schemes for Scheduled Castes/Scheduled Tribes, Education, Housing and Consumption.

Targets and sub-targets under the different priority sectors for different categories of banks have been reviewed and revised periodically. The sub-target for agriculture and allied activities which was set at 15 per cent of Net Bank Credit (NBC) to be achieved by March 1985 was subsequently raised to 16 per cent by March 1987, 17 per cent by March 1989 and 18 per cent by March 1990. In achieving this overall target, the banks were asked to ensure that their direct advances to agriculture should be at least 15 per cent of NBC by March 1985 and 16 per cent by March 1987.

1.3 Financial Sector Reforms and Agricultural Credit

India introduced the process of economic reforms in 1991 in response to the macro economic crisis that developed in early 1990s. The crisis was caused by rising inflation, high level fiscal deficit, low growth and unsustainable current account deficit, the Gulf war of 1990, and the balance of payments crisis. The major objectives of economic reforms were market orientation of the economy, increasing private sector initiative, improving efficiency in government spending, enhancing export competitiveness, foreign capital inflow, stabilizing balance of payment and revamping many sectors of the economy such as industry, trade, finance, infrastructure, etc.

Considering the strategic importance of the banking sector in economic development, Bhasin has come up with the observation that notwithstanding the remarkable progress made by the Indian banking system in achieving social goals during the 1980s, it experienced certain problems that led to decline in efficiency and productivity, and erosion of profitability. Factors such as directed investment and directed credit programmes affected the operational efficiency of the banking system. The quality of loan portfolio also deteriorated. The functional efficiency was affected due to over-staffing, inadequate progress in installing technology and weaknesses in internal organisational structure of the banks (Bhasin, 2006). Since the nationalisation of banks in 1969, the banking sector remained dominated by public sector banks with a significant quantum of non-performing assets. Credit was extended to the Government by mandating the maintenance of a minimum Cash Reserve Ratio (CRR)
and Statutory Liquidity Ratio (SLR) and whereby the commercial banks set aside substantial portions of their liabilities to investment in government securities at below market interest rates. This resulted in low profitability and poor asset quality. These factors necessitated urgent reforms in the financial system. Hence the Government decided to introduce the Banking sector reforms as a part of the comprehensive economic reforms in 1991 with a view to remove the institutional, technological and legal obstacles for the healthy growth of financial markets. It was undertaken with the prime objective to improve the efficiency in the process of financial intermediation, enhancing the effectiveness in the conduct of monetary policy and creating conditions for integration of the domestic financial sector with the global system. The reforms in the financial sector focused on enhancing the operational flexibility and functional autonomy of the financial sector with a view to promote efficiency, productivity and profitability as well as permitting the entry of new private sector banks.

The committee on Financial Systems 1991, commonly known as Narasimham Committee has gone through many aspects of priority sector lending to make financial sector more competitive, efficient, productive, profitable, and transparent. The main recommendations of the committee were reduction in SLR and CRR, deregulation of interest rates, abolishing licensing regarding the branch expansion, transparency in the guidelines or norms for entry and exit of private sector banks, phasing out the directed credit programmes and the concessional rates and introduction of prudential accounting norms relating to income recognition and assets classification. The committee suggested that the priority sector should be redefined and the targeted credit for priority sector should be brought down from 40 per cent to 10 per cent of total bank credit. Simultaneously, in order that banks could compete globally, it wanted major changes in capital adequacy norms and a new institutional structure that was market-driven and based on profitability as the prime criterion. The reform process helped in taking the management of the banking sector to the level, where the RBI ceased to micro-manage commercial banks and focused largely on the macro goals (RBI, 2005). The concept of Non-Performing Assets (NPAs) was introduced for the first time in the Narasimham Committee report 1991. The committee studied the prevailing financial system, identified its shortcomings and weaknesses and made various recommendations in order to make it more stable.
The agriculture sector had seen very little direct reform efforts though the rest of the economy has been undergoing reforms and restructuring. But the reforms in other sector have had an impact on the agriculture sector. The changes brought about in the monetary policy, banking policy, credit policy, exchange rate policy and the like have had different effects on agriculture sector. NABARD has promoted the concept of SHGs approach for financing the poor by formal institution and encourage the non-formal institutions and non-government organisations (NGOs) as well. A beginning was made in the year 1991-92 by linking SHGs with the formal credit agencies.

The sub-target for agriculture and allied activities under the different priority sectors for different categories of banks have been revised in October 1993. It was divided into a minimum of 13.5 per cent for direct loans and a maximum of 4.5 per cent for indirect loans.

In 1995-1996 the government announced the setting up of a Rural Infrastructure Development Fund (RIDF) in NABARD with contributions by commercial banks with shortfalls in their agricultural lending. These contributions were counted as the banks' indirect lending to agriculture. The fund was to assist state governments and state-owned corporations in speedy completion of on-going projects relating to minor and medium irrigation, soil conservation, watershed management and construction of rural infrastructure components such as rural roads and bridges, market yards, etc.

In order to review the progress in the reforms of the banking sector over the past six years with reference to the recommendations made by the Committee on Financial Systems in 1991 and to make necessary improvement, a committee on Banking Sector Reforms was set up under the Chairmanship of M. Narasimham in 1998. In this reform, greater emphasis was placed on structural measures and enhancement in the standard of disclosure and levels of transparency in order to align the Indian standards with best global practices and therefore prudential norms had been introduced gradually to meet international standards. The reforms chart out a programme for further reforms, necessary to strengthen India's financial system so as to make it internationally competitive due to the global changes occurring in the world economy, which made each industry very competitive.
An important initiative for universal access of farmers to institutional credit, the KCCS (Kisan Credit Card Scheme) was introduced in August, 1998. The scheme facilitated the farmers for easy and timely access to short-and medium-term loans for purchasing farm inputs while conducting seasonal agricultural operations for raising crops. The scheme is being implemented by the commercial banks, cooperative banks and RRBs.

“The Expert Committee on Rural Credit” (Chairman: V.S. Vyas, 2001) appointed by NABARD in the year 2000 recommended in its report dated July 23, 2001 that a review of the mandate of 18 per cent of credit outstanding for agricultural loans and 40 per cent for priority sector loans be made after five years, as it believed that Indian agriculture was likely to experience substantial, structural and other changes in this period of five years and the experiences of this period would provide a base for a more realistic reappraisal. The committee recommended that the maximum limit of 4.5 per cent of indirect credit should be maintained while reckoning the achievement of 18 per cent target for agricultural lending.

The Government of India announced a “Comprehensive credit policy” in June 2004, to double the flow of agricultural credit by all the financial institutions over a period of three years starting from 2004-05. It includes the commitment to raise agricultural credit flow by 30 per cent every year, financing of 100 farmers per branch (thus, 50 lakh farmers in a year), two to three new investments in agricultural projects per branch every year and a host of debt-relief measures, such as debt restructuring, one-time settlement and financial assistance to redeem loans from moneylenders (Ministry of Agriculture, 2007). Therefore, 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 supervising the implementation of the programme. In 2003-04, total agricultural credit by all financial institutions stood at ₹ 86,981 crore. During the first year of the programme (2004-05), the institutional credit to agriculture was ₹1,25,309 crore which increased to ₹1,80,486 crore in 2005-06 and further rose to ₹2,03,297 crore in the last year of the programme (2006-07). Hence, the credit flow to farm sector doubled during two years as against the stipulated time period of three years.

In 2008-09, the government took note of the recommendations of the Radhakrishna Expert Group and announced a scheme of agricultural debt waiver and
debt relief for farmers. All agricultural loans disbursed by SCBs, RRBs and cooperative credit institutions up to March 31, 2007 and overdue as on December 31, 2007 was covered under the scheme. For marginal farmers (i.e., holding up to 1 hectare) and small farmers (1-2 hectare), there was a complete waiver of all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008. In respect of other farmers, there was a one-time settlement (OTS) scheme for all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008. Under the OTS, a rebate of 25 per cent will be given against payment of the balance of 75 per cent. The implementation of the debt waiver and debt relief scheme will be completed by June 30, 2008. Upon being granted debt waiver or signing an agreement for debt relief under the OTS, the farmer would be entitled to fresh agricultural loans from the banks in accordance with normal rules. Agricultural loans were restructured and rescheduled by banks in 2004 and 2006 through special packages. These rescheduled loans, and other loans rescheduled in the normal course as per RBI guidelines, will also be eligible either for a waiver or an OTS on the same pattern.

1.4 Organisation of Rural Credit

The agricultural credit can be obtained for different purposes from different sources under different terms and for different time periods. It can be classified according to the institution wise, purpose wise, period wise and security wise.

Indian farmers acquire their credit requirement from various sources which are broadly classified into institutional and non-institutional sources of credit. The institutional sources of agricultural credit include Cooperatives, Scheduled Commercial Banks and Regional Rural Banks, which are commonly known as multi-agency network (see Table 1.2). On the other hand, the non-institutional sources of agricultural credit comprises professional and agricultural moneylenders, landlords, traders, commission agents and the cultivator’s relatives and friends and others who usually charge unreasonable rates of interest.

The flow of agricultural credit from the multi-agency networks consists of mainly two types viz., direct and indirect credit. The direct agricultural credit is given directly to the cultivators for farming operations and assets such as credit for crop production, land development and minor-irrigation development, purchasing animals,
farm machinery, implements and equipments, development of plantation, etc. The indirect agricultural credit advances to agencies engaged in the supply of production input and services to the agriculturists such as for financing PACS and distribution of farm inputs, financing state electricity board for energisation of pumping-sets, etc.

Table 1.2: Institutional Structure of Agricultural Credit in India (As on March 31, 2013)

<table>
<thead>
<tr>
<th>Scheduled Commercial Banks</th>
<th>Public Sector Banks (26)</th>
<th>State Bank of India and Its Associates (5)</th>
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<td></td>
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<td></td>
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<td>Other Public Sector Banks (1)</td>
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<td>Old Private Sector Banks (13)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>New Private Sector Banks (7)</td>
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<tr>
<td>Regional Rural Banks (64)</td>
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<td>Limited area of operation</td>
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<td></td>
<td></td>
<td>District Central Cooperative Banks (371)</td>
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<td></td>
<td></td>
<td></td>
<td>Primary Agricultural Credit Societies (92,432)</td>
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<tr>
<td></td>
<td></td>
<td>Long-Term</td>
<td>State Cooperative Agriculture and Rural Development Banks (20)</td>
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<td>Primary Cooperative Agriculture and Rural Development Banks (697)</td>
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Source: Department of Banking Operations and Development (DBOD) and Department of Economic and Policy Research (DEPR) 2013, Reserve Bank of India.

Purpose wise agricultural credit can be classified into two categories: (i) Productive and (ii) Unproductive. The loans which are used in productive operation of agriculture are called productive credit. It includes loans for the purchase of seeds, fertilisers, manures, agricultural implements, livestock, etc. The repayment of this loan by farmers is generally not difficult because the very process of production generally creates the income for repayment. On the other hand, there are personal reasons and other social obligations which includes performance of marriages, social
ceremonies on the birth or death of a family member, religious functions, festivals, etc, for which the credit is required and is known as unproductive. Besides it include credit for consumption purposes because in between the moment of marketing of agricultural produce and harvesting of next crop, there is a long interval of time and most of the farmers do not have sufficient income to sustain them through this period. Therefore, they have to take loans for meeting their consumption needs. In the time of droughts or floods, the crop is considerably damaged and farmers who otherwise avoid taking loans for consumption, have also to incur such loans.

According to period wise, it can be classified as short-term, medium-term and long-term credit. Short-term credit is for variable items of capital or seasonal inputs such as seeds, feed fodder for farm animals, fertilizers, fuel, pesticides, casual labour, etc. The loans are provided for a period of less than 15 months. Medium-term credit is for working capital assets such as machinery, diesel engines, wells, irrigation structures, threshers, crushers, bullocks, dairy animals and so on. The period is normally from a minimum of one year or more than 15 months to a maximum of 5 years. Long-term credit is for permanent land improvements, purchase of land and expensive agricultural equipments, soil conservation and for repayment of old debts. The loans are provided for a period of more than 5 years.

Security wise agricultural credit can be classified into secured and unsecured. Secured loans are those given on the basis of securities such as personal security of another person, mortgaging the property, hypothecation etc. Unsecured loans are those which are not based on security but given on personal security.

1.5 Objectives of the Study

The overall objective of the study is to evaluate the role of banking sector in agricultural finance during the post-reform period in India.

The specific objectives are:
1. To analyse the share (trends and composition) of institutional credit to agriculture sector during the post-reform period in India.
2. To examine the inter-regional variation in the disbursement of agriculture credit during the post-reform period in India.
3. To measure the credit gap among farmers across the size of land holding during the post-reform period in India.
4. To estimate the contributed share of institutional credit to agricultural production during the post-reform period in India.

1.6 Hypotheses of the Study

(i) Institutional credit to agriculture has no significant impact on agriculture sector during the post-reform period in India.

(ii) There is no inter-regional variation in agricultural credit during the post-reform period in India.

(iii) There is no credit gap among farmers across the size of land holding during the post-reform period in India.

(iv) The availability of institutional credit to agriculture has negative impact on agricultural gross domestic product during the post-reforms period in India.

1.7 Scope and Limitation of the Study

The study focuses attention on the contribution of institutional credit to agriculture sector at the regional level as well as at the all India level and its impact on the agricultural production. It throws light on the supply of institutional credit by different agencies like co-operatives, scheduled commercial banks and regional rural banks in the area of agricultural operation. The credit gap amongst the various sizes of land holdings will also be lighted. Hence the findings of the study would be useful to assess the nature of agricultural credit at all India level and regional level as well as among the size of land holdings. Besides, it would be helpful in policy-framing with regard to distribution of credit among different groups of farmers and regions for various agricultural purposes by different institutional agencies.

The analysis has covered macro aspects of the institutional credit to agriculture. On wider perspective the study explores the variables at all India level, while at the regional level the study is based on the six regions comprising of Northern, North-Eastern, Eastern, Central, Western and Southern region. The study is limited for the period from 1975-76 to 2009-10. The justification of selecting this period is that published data is available for up to this period only. For the purpose of analysis, the financial years namely, 1975-76 to 2009-10 has been treated as 1976 to 2010 respectively. This period has been divided into two sub-periods namely: (i) Pre-reform Period – 1975-76 to 1990-91 and (ii) Post-reform Period – 1991-92 to 2009-10.
The study will cover only crop production in ‘agriculture’ excluding other allied activities like diary, fishery, poultry, horticulture, etc. It does not include the functioning of non-institutional agencies such as money lenders, traders, relatives and friends, etc. It will exclude institutions like Agriculture Refinance and Development Corporation (ARDC), Agricultural Finance Corporation (AFC) and NABARD, which support the institutional credit structure in many ways but do not advance credit directly to farmers. Further it also excludes financing help which has been given by the Government as an agency like *taccavi* loans. The data since 1999-2000, covers not only the PACS but also the SCARDBs and PCARDBs of the long-term credit by cooperative societies, while the earlier period covered only PACS. The data of total outstanding credit (direct and indirect) excludes the data of Rural Electrification Corporation Ltd. (REC) of indirect outstanding credit.

1.8 Chapter Scheme

The entire study has been systematized by segmenting the facts and figures into various heads called different chapters, which are organized in a logical sequence. The study is arranged into five chapters which are as follows:

The opening chapter is that of the introduction of the study and it presents the importance and evolution of institutional finance to agriculture, financial sector reforms and agricultural credit, objectives, hypothesis, scope and limitations of the study.

Chapter two provides a review of related literature where views, opinions, observations and findings of different researchers (as found in different articles, journals, books, etc) on issues relevant to agricultural credit. This chapter will discuss on the performance and problems of institutional credit, and its inter-regional variation and credit gap amongst various sizes of land holdings in agriculture specifically after post-reform period. For the purpose of better understanding, the period of study has been divided into three distinct phases. The first phase will be from 1950 to 1969 when co-operative credit societies were the primary vehicle of institutional agricultural credit. The second phase will be from 1969 to 1990 during which the nationalization of 20 major commercial banks was undertaken. The banks were henceforth assigned an important task of providing agricultural credit to supplement the credit provided by the co-operatives. In 1975, Regional Rural Banks
were established to provide credit to small and marginal farmers and weaker sections of society. And in the third phase, beginning with the financial sector reforms of the 1990s, emphasis was shifted in favour of prudential regulations and hence the focus on social banking got diluted.

Chapter three discusses the locale of the study, sources and nature of data used, various statistical tools and techniques employed for analysing the data. It also provides the definitions of the terms and concepts that are used in the study.

The fourth chapter consists of the analysis on the trends and composition of different institutional credit to the agriculture during the pre and post-reform period in India. Here the inter-regional variations, credit gap amongst the size of land holdings and loans distribution of loans according to the credit limit size-classes by scheduled commercial banks during the reform-period is analysed. The study is sub-divided under the headings-

I. **Trends in the Growth of Agricultural Credit** wherein the trends in the growth of direct and indirect institutional credit to agricultural for the period 1975-76 to 2009-10; the share of direct short and long-term institutional credit to agriculture; the comparison of the trends prevalent during the post-reform period and the pre-reform period are examined.

II. **Credit Flow to Agriculture: From Different Types of Credit Institutions** under which the composition of different agencies of institutional credit to agriculture sector comprising the co-operative credit societies (the oldest credit agency amongst the multi-agency network established in 1904), the regional rural banks (established in 1975 for providing concessional credit to small and marginal farmers) and scheduled commercial banks (which lends direct and indirect credit to agriculture sector) is analysed.

III. **Region-wise Distribution of Institutional Credit to Agriculture** in which the estimation of the inter-regional variations in the supply of institutional credit to agriculture by scheduled commercial banks during the post-reform period (1992-2010) in all five regions of India (namely Northern, North-Eastern, Eastern, Central, Western and Southern) is studied. The growth rates for credit to agriculture for two sub-periods, viz., 1992-2000 (early post-reform period) and 2001-2010 (later post-reform period) are also analysed under this heading.
IV. **Size-wise Distribution of Institutional Credit to Agriculture** wherein the
distribution of direct institutional credit (short and long-term) to farmers by
scheduled commercial banks according to the size of land holdings during the
post-reform period as well as distribution of institutional credit to agriculture
(direct and indirect) according to credit limit size-classes of loans by
scheduled commercial banks during the post-reform period will also be
evaluated.

Fifth chapter describes the impact of financial sector reforms initiated in the
early-1990s on agricultural production. For assessing the impact of reforms the study
will use Cobb-Douglas production function based on ordinary least squares method
for pre and post-reform period. The variables used in the study are agricultural gross
domestic product, institutional credit, gross sown area, gross irrigated area,
agricultural labour force, consumptions of fertilizers and rainfall during the period of
June to September. There are also other important variables (improved seeds, tractors,
electricity, pesticides, etc.) which determined agricultural production but they can be
purchased only with the availability of credit. The variables uses in the study have
been collected from different secondary sources. The empirical results will focussed
on the impact of availability of institutional credit on agricultural gross domestic
product during the post-reform period.

The last chapter summarises the study, and discusses the conclusions and
policy implications regarding improvement in the flow institutional credit to
agriculture sector.