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1.1 Introduction

Banking system in India has undergone a major structural transformation after 1969 when fourteen major commercial banks were nationalised. Besides a phenomenal expansion in the network of branches, particularly in the rural and other under-banked areas, there has been a significant qualitative change in the operations of the banking system in India. The varieties of new responsibilities entrusted to the country’s banking system belong to the area of social banking for which there are hardly any precedents.

“Banking system in India has helped in the development effort in a big way. Given the important role of the public sector in the process of development in India, it is natural for the banking sector to make available part of the savings mobilised by it to the public sector. To fulfil this objective, the statutory liquidity ratio has been progressively raised. Banks make resources available to public sector agencies through their participation in market borrowing programmes at rates which may not even cover their costs. They also make available huge and growing proportion of their credit to the priority sectors on highly concessional rates. The proportion of bank credit made available for financing the public procurement of food grains, raw cotton and raw jute, again on concessional terms, has also been increasing steadily.”

“The Indian banking system appears to have responded well to its responsibilities, particularly in the field of rural credit. Of the 50 thousand additional bank-offices opened since 1969, nearly 40 thousand offices, i.e. 80 per cent, are located in rural and semi-urban areas. The share of direct agricultural advances has gone up from 1.3 per cent to nearly 15 per cent in June 1986. However, the mounting over dues of bank loans to agriculture in recent years are seriously impairing the ability of the banking system to recycle its credit to meet the progressively increasing demand for it in the rural sector. This situation needs to be carefully reviewed and factors contributing to it have to be promptly eliminated. The writing-off of loans, in the garb of social justice, is bound to accentuate the malady of over dues.”
Banking system in India has also been called upon to play an increasingly significant role in the Special Area Programme under the five year plans. Their role in IRDP has been significant and the banking system has made loan disbursements under this programme which have exceeded targets laid down. As the extent and scope of such anti-poverty programmes is accelerated, the banking system will have to be geared to cope up with the responsibilities that these programmes entail. It is, however, to be noted that growing proportion of concessional credit both in the field of agriculture and industry (sick industries, small scale industries etc.) reduces the profit earning capability of the banking system. For earning its profits, the banking system is likely to raise its lending rates to the healthy industrial units which may become counter-productive if it slows down the rate of industrial growth.

Developments in the field of cooperative banking are equally impressive. The primary agricultural credit societies have been reorganized and strengthened over time. Consequently, although their number has declined, their membership has increased rapidly. “The loans advanced by these societies have also increased almost twentyfold between 1951 and 1988. Long term credit extended by the land development banks has also made rapid strides. The progress on the rural credit front has been greatly facilitated by the strengthening of the institutional structure for rural credit by the Reserve Bank of India.”

The Reserve Bank of India, as the apex credit institution, has made singular contribution towards the institutionalization of saving and investment by promoting and extending banking services. As the monetary authority, it has been discharging its duties efficiently under growing strains on the monetary system. With a view to ensure that the monetary system in the country grows not only to meet the requirements of growth but also to ensure harmony with the fiscal system, the Reserve Bank of India has been constantly reviewing its monetary policy. Fresh changes in the monetary system, as suggested by the Committee to Review the Working of the Monetary System, are on the anvil.

Banking services are a critical input for growth. Their coordinated growth across regions and sectors of an economy is a vital requirement of balanced growth.
Banking system in India has obviously been making rapid strides in this direction. Its expansion has, unfortunately, been accompanied by progressive deterioration in its customer-services. Modernization of banking system might facilitate an improvement in this direction as well.

The banking system forms the core of the financial sector of the economy. The role of commercial banks is particularly important in underdeveloped countries. Through mobilisation of resources and their better allocation, commercial banks play an important role in development process of underdeveloped countries. By offering attractive saving schemes and ensuring safety of deposits, commercial banks encourage willingness to save among the people. By reaching out to people in rural areas, they convert idle saving in to effective ones. Commercial banks improve the allocation of resources by lending money to priority sectors of the economy. These banks provide a meeting ground for the savers and the investors. Savers may not invest either because of inadequate savings and/or lack of risk taking spirit.

1.1.1 Classification of Commercial Banks in India

Commercial banks can be classified as follows:

- **Scheduled and Non-Scheduled Banks**
  A Scheduled bank is one which is included in the second schedule of RBI Act, 1934. Certain conditions are to be satisfied to be eligible for this as, for example, a bank must be a corporation and not a partnership or a single owner firm. Scheduled banks enjoy certain facilities like borrowings from the RBI. In return they have to meet certain obligations of RBI like, maintaining a part of their cash reserves with the RBI.
  Non-Scheduled Banks are disappearing from the banking scene and hence they are not important.

- **Indian and Foreign Banks**
  Indian banks are those which are incorporated in India and have their head offices in India. Some big Indian banks have their branches in foreign countries.
  Foreign banks are incorporated in foreign countries with their head offices outside India. They are scheduled banks and specialise in the field of foreign exchange.
Public Sector Banks and Private Sector Banks
The Central Government entered the banking business with the nationalisation of Imperial Bank of India (now SBI) in 1955. In 1969, 14 large banks were taken over by the government. Those nationalised banks are called public sector banks and the others are private sector banks.

1.1.2 Banking Sector Reforms and Its Stages
Prior to economic reforms initiated in early Nineties, the banking sector in Republic of India suffered from lack of competition, low capital base, unskillfulness and high intercession prices. The banking industry dominated by the general public sector was subject to a high degree of monetary repression, characterised by administered interest rates and allotted credit. Reforms in the commercial banking sector had 2 distinct phases. The Ist phase of reforms introduced subsequent to the release of the Report of the Committee on Financial System (Chairman: M. Narasimham), 1992 which mainly focussed on Enabling and Strengthening measures. The IInd phase of reforms introduced subsequent to the recommendations of the Committee on Banking Sector Reforms (Chairman: M. Narasimham), 1998 which placed greater emphasis on structural measures and improvement in standards of disclosure and levels of transparency in order to align the Indian standards with international best practices.

Reforms have caused significant enhancements as mirrored in varied parameters concerning capital adequacy, asset quality, profitableness and operational efficiency. Though commercial banks were facing the matter of overhang of non-performing assets (NPAs), high spread and low profitability in comparison with banks in alternative rising market economies, reforms are undefeated in enhancing the performance of commercial banks in terms of both stability and efficiency parameters.

Nationalisation of commercial banks was considered as mixed blessing because after nationalisation of banks there was a shift of stress from trade to agriculture and the country witnessed fast enlargement in bank branches and in rural
areas also. However, bank nationalisation created its own issues like excessive bureaucratisation, red-tapism and turbulent techniques of trade unions of bank staff.

It was in this backdrop that wide-ranging banking sector reforms were introduced as associate integral a part of the economic reforms programme started in early Nineties and that continues to be underneath manner.

1.1.3 Contours on Banking Sector Reforms

Banking sector reform is essentially a 1990’s phenomenon. In the post-independence period, the Indian financial sector in general, and the banking sector in particular, evolved through three distinct phases.

- First phase of reforms (1947-1968)
  The first period, 1947-1968, was one in which the RBI sought to consolidate its role as the agency in charge of supervising and controlling what was largely private banking system. A substantial part of the Indian banking sector was concentrated in the hands of a few business groups and it operated in a fairly liberal environment. Growing evidences showed that advances by private banks were diverted to sister companies of the banks or to companies in which their directors had an interest. Further, bank advances tended to favour the urban industrial sector, resulting in an inadequate expansion of banking in rural areas.

- Second phase of reforms (1969-1990)
  The second period started in 1969 with the nationalization of fourteen commercial banks, which gave the RBI a more direct and active role in banking policies. The main role of RBI was to meet social objectives such as reduction in inequalities of income and concentration of economic power. As a consequence, policies such as interest rate controls and pre-emption of resources through credit programmes directed towards agriculture and the small-scale sector increased in magnitude during this period. There was conjointly a united effort at substantially increasing the reach of the banking
system, particularly to the agricultural areas. The success of those policies, in terms of branch growth, mobilization of household savings, diversification of disposal targets and direction of credit to the priority sector, was so substantial. While lending to the priority sector by public sector banks exceeds 40 percent of net bank credit today, it stood at a mere 14.6 percent in 1969.

- **Third phase of reforms (1991 onwards)**
  During the third phase, which began in 1991, there has been a continuous process of dilution of controls over and regulation of the banking system. This process of liberalization and the practice of regulatory forbearance came in the wake of an almost orchestrated campaign, starting in the 1980s, the low profitability, and low capital base, high NPAs, ostensible inefficiency and lack of transparency of public sector banks. Such criticism constituted the point of departure for the Committee on the Financial System established in 1991 under the chairmanship of M. Narasimham, to pave the way for the liberalization of banking practices. The declared aim of the Committee was to improve the financial performance of the banks and to strengthen the qualitative character of their credit operations, which it sought to, achieve by providing them a great degree of functional autonomy and operational flexibility. The recommendations of the Committee were grouped into two broad areas: those concerned with improving the efficiency, productivity and profitability of bank operations; and those relating to enhancing their operational flexibility and autonomy in decision making. In practice, the implementation of these recommendations has ensured a transformation of Indian banking, reducing its role as an instrument for realizing development objectives while increasing its profitability through changes that raises the fragility of the financial system.
1.1.4 Objectives of Study

In the light of these issues, the present study on credit flow to agriculture derives its relevance by analyzing the temporal behaviour of variables with the following objectives:

- To examine all India level trends of institutional credit to agriculture before and after the introduction of the banking sector reform, and analyze the contributing factors.
- To examine the relative share of different agencies in lending to agriculture in pre and post reform period.
- To study various policy measures of banking sector reforms.
- To examine the performance of Commercial Banks regarding rural and agricultural credit during the study period.
- To examine the performance of RRBs regarding rural and agricultural credit during the study period.