CHAPTER - I

SELECT REVIEW OF LITERATURE AND METHODOLOGY

"That's very important," the King said, turning to the jury. They were just beginning to write this down on their slates, when the White Rabbit interrupted: "Unimportant, your Majesty means, of course," he said in a very respectful tone, but frowning and making faces at him as he spoke.

"Unimportant, of course, I meant," the King hastily said, and went on to himself in an undertone, "important-unimportant-unimportant-important-" as if he were trying which word sounded best.

--ALICE IN WONDERLAND

1.1 INTRODUCTION

Rural credit investigation assumes significance in the developing world as rural credit occupies a critical place. Despite rapid strides made in urbanisation most Third World economies remain essentially rural. Agriculture, both traditional and modern is the dominant occupation. Rural non-farm enterprises and service activities have tended to diminish due to the onslaught of urban industry and service nexus. The rural economic structure, therefore, is in a state of flux. Cropping patterns are undergoing a steady change. Yield levels have gone up along with the extension and consolidation of irrigation and the application of modern inputs in the place of the traditional
Consequently, the demand for credit has accelerated. The provision of credit for modern agriculture on timely and adequate basis has become one of the components of the strategy of agricultural development based on high pay-off inputs model. The study of the credit market both formal and informal is receiving greater attention now than before in view of its impact on the rural economic structure especially in the context of poverty alleviation programmes.

1.2 THE BURGEONING LITERATURE

The literature on the subject of rural credit is abundant and is burgeoning. The theoretical heritage is as old as economic analysis. The empirical literature is a perennial river at least since the publication of the All India Rural Credit Survey in 1954. The World Bank is primarily concerned with the efficient functioning of rural financial markets in the Third World. The use and abuse of financial markets by governments guided by short-term interests and considerations of political patronage are the major themes of some of its recent publications which have attracted the attention of all scholars in the field. Since the publication of U.Tun Wai's paper, a new awakening is brought about in the working of the organised and the unorganised money markets and how the dichotomy between them has tended to persist. The fragmentation and differentiation of the rural financial
market has come to attract the attention of academics and planners in the context of rural development programmes. But the literature pertaining to micro-level studies is scanty and more and more area-specific studies on the structure and working of credit market are needed for a better understanding of the market. It is against this background that the present study is proposed. Before we present the methodology of the present study it is appropriate to go in for a select review of literature on the subject of the present study.

1.3 USE AND ABUSE OF RURAL FINANCIAL MARKETS

J.D Von Pischke, et al. edited work "Rural Financial Markets in Developing Countries: Their Use and Abuse" highlights facets of Rural Financial Markets (RFMs) that have often been neglected in discussions of agricultural credit in developing countries. It moves beyond a narrow concern with the simple provision of credit to a broad consideration of the performance of Rural Financial Markets and of ways to improve the quality and range of financial services for low income farmers. It reflects new thinking on the design, administration, evaluation and policy framework of rural finance and credit programmes in developing countries.

Many authors in this book assert that farmers in developing countries are rational in their use of financial markets. This
Conclusion has important implications for the way RFM interventions are designed. It strongly suggests that supply-led strategies for rural development ought to be deemphasized; rather than merely increasing the supply of loanable funds, attention should be directed towards improving the range and quality of rural financial services. Co-operatives have been instruments of government policy rather than business minded organisations serving their members. A common type of co-operative is the single purpose farm credit society, which is often a losing business proposition. Credit unions and multipurpose co-operatives have done much better.

Studies relating to government policies toward Rural Finance emphasize the noticeably negative effects of such policies in terms of greater inefficiency in resource allocation, penalization of financial savings, credit rationing favouring a few large farmers, and the consequent unequal distribution of income, the encouragement of loan defaults, an impaired viability, financial intermediaries, incentives for capital-intensive production which is not so efficient in developing countries. Excessive governmental regulation has often transformed RFMs into an instrument for introducing political patronage into the allocation of credit.

On the whole, it seems to disprove the traditional
assumption that the growth in the volume of credit extended at concessional rates of interest is a prerequisite for the development of agricultural production and, therefore, for the improvement of the standard of living in rural people and emphasizes the need to adopt an integrated approach in both the analysis of RFMs and in the consequent working out of appropriate measures to develop them.

The authors repeatedly underline the importance of exploiting the savings potential of rural areas and emphasize the need for a greater autonomy for and greater competition among financial intermediaries. Government's intervention, on the other hand, should ensure the conditions for a correct and free functioning of RFMs.

The specific measures required to improve the quality of RFMs in different economies will vary. But it appears that most efforts should contribute towards the integration of these markets, emphasize voluntary savings mobilization by formal institutions and allow interest rates to be determined flexibly by market forces.

1.4 INTERLINKED FACTOR AND PRODUCT MARKETS

Keith Griffin\textsuperscript{2} analyses the structural characteristics of different factor markets including credit market in his work "The Political Economy of Agrarian Change". His major hypothesis is
that economic and political power is concentrated in a small group and, as a result, factor markets are highly imperfect. He advances the view that factor and commodity markets are interlinked. For example, a single land owner may enter into myriad transactions to supply his villager with some land on a cropsharing basis, production credit, some material inputs, a homestead, consumption loans, and employment on his self-operated holding in addition to undertaking the job of marketing the tenant's share of the output. A landowner may supply credit 'free' to his tenant and then recoup the loss by charging a higher rent for land or by obtaining a higher share of crop for himself. A casual labourer may be given a free advance for consumption, in cash or kind by his employer and in return he works at a lower wage rate than that paid to others. A farm servant may be provided with rent free homestead in return for a certain number of additional days of work by members of his household. In situations such as these wage, rental, and interest rates, and even the price paid to tenant for his marketed surplus cannot be understood unless the entire relationship between the transactions is taken into account. In the underdeveloped rural areas the prices of the agricultural inputs particularly the prices of the material inputs are 'political prices' not prices determined exclusively by economic forces. Government intervention in market processes through
taxes, subsidies, quotas and rationing is widespread and to comprehend the set of relative prices that results one needs a theory of politics and state as much as a theory of economics. Many resources are allocated by the state bureaucracy either at a price below a market clearing price or at no charge at all. In underdeveloped rural areas in many instances, in fact, there is a multiplicity of markets within a locality for a single factor of production e.g., credit. Imperfections in the rural capital market, however, are ubiquitous and more pronounced. Large farmers have ready access to commercial banks outside the farming locality and can obtain loans at preferential interest rates since their wealth, income and status make the risk of lending to them minimal. Furthermore, the large farmers are able to use their political influence to ensure that government credit programmes cater to their needs. The small peasant, in contrast, has little working capital and restricted access to credit. Different policies can have quite different consequences for the two groups. Finally the book examines the mechanisms which are eroding the agrarian structure of much of the underdeveloped world and analyses the implications of these changes for the well-being of those who live and work in rural areas.

Kaushik Basu's "The Less Developed Economy" is organised into four parts. Part one deals with introduction and macro
perspectives, while part two enquires into the structure of a dual economy. The third part deals with certain specific aspects of rural economy namely stagnation in backward agriculture, tenancy and efficiency, isolation and usury, and an analysis of rural credit markets and a theory of interlinked rural markets. The concluding part probes into the limits of economic analysis employed in the book. The relevant portion of the book for the present understanding is the analysis of rural credit markets and interlinked rural markets. In the former analysis he tests the moneylenders' risk hypothesis which asserts that moneylenders in backward regions face a positive risk of default. The crux of the hypothesis is the observed high rural interest rates are illusory. Though this hypothesis may be useful in some situations, it is quite inadequate as a general proposition. For a fuller explanation it is necessary to take into account the monopolistic nature of credit markets as Bottomley (1964) and K.N. Raj (1979) did. The village moneylenders' monopoly power arises from his intimate knowledge of the borrowers' circumstances. Since the moneylender, in general, has access to the urban credit market, the model also explains why rural interest rates are typically above the urban rates. Since the rural credit market is fragmented into little monopolistic islands a typical case of discriminating monopoly - the rural economy itself is characterised by a whole array of interest
rates. The monopoly power model is open to two important criticisms. First the criticism is applicable to monopoly analysis in general where the lender does not maximise his profit on the basis of "all - or nothing" contracts. Secondly, the analysis presumes that the borrower always has enough money to repay a loan which is unrealistic due to widespread poverty of rural borrowers. He is then forced to repay a part of the debt in terms of whatever he has; livestock, utensils or even labour. These assets are usually not marketable. The borrowers' and lenders' valuation of the asset/service can be different and the lender may enter the credit market with the express purpose of acquiring assets kept as a security. The issues connected with this line are dealt with in collateral price and interest rate formation model. This model was constructed without bringing uncertainty directly into the picture. Rural credit markets may get isolated and fragmented either because the credit transactions are intertwined with some other transactions or because of hereditary connections between the agents of exchange. The author analyses the emergence of interlinkage in terms of "potential risk", employing partial and general equilibrium approaches and linking the endogenous variables and the response to exogenous changes in the factor and produce markets. This monograph discusses models of different degrees of generality.
Non-economic issues and methodological questions receive only cursory attention. It brings together some works which are apparently different on ideological strains and shows that some of the differences in jargon of different schools, the areas of contention turn out to be smaller than generally supposed. It, therefore, serves as a bridge between different schools of thought.

1.5 NATURE OF CREDIT MARKET AND CREDIT ALLOCATION

Arvind Virmani in his paper on "The Nature of Credit Markets in Developing Countries" analyses various forms of government intervention in the loan market in terms of their effect on efficiency. This provides the essential basis for evaluating and judging these policies. It also shows where earlier policy prescriptions are correct, incomplete or wrong. One of the implications of the paper is that the credit market differs fundamentally from the market for ordinary goods and services. Consequently, conventional analysis of the loan markets, based on the theory applicable to product markets, can be misleading even when similar prescriptions are reached. Another important highlight of the paper is the vital role of collateral in the loan market. These two issues are addressed in the introductory discussion on the special nature of credit markets, which forms an important prerequisite for understanding
the subsequent sections of the paper. The paper focuses its attention exclusively on one of the underlying reasons for government intervention namely market failure in the credit market. It examines the causes and consequences of market imperfections or failures in the rural credit structure and the effects of different types of intervention and their implications for different policies for correcting market imperfections on the loan side of the market. It assumes the deposit side of the market as given.

The paper provides a unified framework for analysing credit markets, allows apparently desperate observations and facts in the banking and institutional literature to be understood and interpreted.

Arvind Virmani in his working paper on "Evaluation of Financial Policy: Credit Allocation in Bangladesh" analyses the various credit policies and programmes of Bangladesh. The Bangladesh Government like many developing countries has used a variety of policies to influence the allocation of credit to specific borrower groups like poor farmers, to uses such as housing, and the sectors such as agriculture. The policies have also been employed to reduce allocation for certain uses such as inventory holding. The instruments employed were interest controls, credit guarantees, refinance and margin requirements. The paper attempts a systematic analysis of all the policies used
by Bangladesh Government in the light of the explicit or implicit objectives of the Government. The effect of each of these policies used, either alone or in combination is analysed with a view to evaluating their usefulness and efficiency. The analysis thus provides the basis for policy makers in other countries. This paper applies the analytical framework developed earlier by the author in "The Nature of Credit Markets in Developing Countries: A Framework for Policy Analysis". A distinction between empirical testing practical application needs to be borne in mind in reading the paper. The former was not attempted, given the data limitations and time constraints under which the paper was written. It is presented more as a practical guide to others wishing to apply the same framework in the context of similar limitations.

David D.Bathrick in his critical work "Agricultural Credit for Small Farm Development: Policies and Practices" explains that agricultural credit should be viewed not in isolation but in relation to supporting services and the needs of improved technology. U.S. agricultural credit models based on individualised supervision approach cannot be replicated in developing countries. The overview summarises also the evolution of ideas on policy issues pertaining to eligibility criteria and security requirements, interest rates and the merits of interest
subsidies, repayment performance and credit channels. A glaring omission in the overview is the inadequacy of attention to the interrelationship between agrarian structure and inadequacy of credit to the small farmers on one hand, and the preferred model of the institutional systems of credit, on the other. The critical operational problems identified by the author pertain to management information systems, project evaluation systems, quality of supporting services, loan approval considerations, centralisation vis-a-vis decentralisation of organisation, personnel matters, and management and personnel administration systems. The purpose of the Nicaraguan case is to illustrate how these operational problems in developing effective credit management systems for the small farmers are sought to be solved. The scope of this book is limited to operational aspects, and there is little documentation on how the improved systems contributed to the fulfilment of management objectives of INVIERNO and the agrarian structure in Nicaragua immediately before the downfall of Somaza Government.

1.6 R.B.I STUDIES ON RURAL CREDIT

In India, several studies, official as well as non official, have been undertaken from time to time in the field of farm finance at the national and state level. The All India Rural
Credit Survey (AIRCS) was the first comprehensive and scientific study conducted by the Reserve Bank of India (RBI). The findings of the survey committee confirmed the dominant position occupied by the moneylender in the Rural Credit market. It observed that agricultural credit fell short of the right quantity, was not of the right type did not serve the right purpose and often failed to go to the right people. Rural artisans, agricultural labourers and other classes of the group of non cultivators are not usually able to obtain accommodation from co-operatives. The committee also observed that although the performance of the co-operatives in the sphere of agricultural credit was deficient in several ways, the co-operative agency still remained by far the least unsatisfactory channel of credit and summed up its approach in the statement 'co-operation has failed, but co-operation must succeed'.

The RBI constituted the All India Rural Credit Review Committee in 1966, with a view to reassessing the development that had taken place in the field of rural credit since 1954. The Review Committee submitted its report in July 1969. The committee, inter-alia, recommended that besides strengthening the co-operative credit structure, commercial banks should embark on wide and intensive effort for provision of agricultural credit.

The All India Debt and Investment Surveys have thrown up a mine of information relating to the structure of rural assets and
rates of interest. Besides, the RBI has undertaken several empirical and evaluative studies in the sphere of rural credit in India.

1.7 Khusro Committee

In August 1986, the Reserve Bank of India appointed yet another Agricultural Credit Review Committee which submitted its report in August 1989. While the refrain of all previous committees and working groups had been that the co-operatives have not done as well as they should have, the Khusro Committee (1989) points out that the experience of commercial banks and RRBs has shown that the weaknesses which were earlier considered as those peculiar to the co-operative system in fact arise from such deficiencies as relate to the structure of agricultural production itself. But, then it missed the point and said nothing about how to restructure agricultural production. Instead, like all previous committees and working groups, it proceeded to consider how to reorganise the structure of rural credit as though this was a substitute to reorganise the structure of agricultural production. The three main elements in the structure of rural credit are the commercial banks, the regional rural banks, and the co-operatives. The committee considered them in that order.
As the committee points out that the place of the commercial banks in the rural credit system rests on the fact that, if lendings to rural and weaker sections are to be at concessional rates, there has to be some cross-subsidisation and, in the Indian context, only commercial banks have the capacity to do it. But too much burden has been placed on the commercial banks. They are mandated to achieve certain targets and sub-targets under priority sector lendings. Forty per cent of the total credit is required to be channelled to identified priority sectors such as agriculture, small-scale industry, small business, etc. Direct finance to agriculture and allied activities is to reach a level of 17 per cent of net bank credit and credit for weaker section 10 per cent. All these targets were achieved by the banks by March 1988. The share of commercial banks in Integrated Rural Development Programme (IRDP) loans has gone up to 69 per cent, compared to 23 per cent that of RRBs and 8 per cent that of cooperatives.

The commercial banks have found sanctioning and monitoring a large number of small advances in their rural branches. There were time consuming and manpower-intensive and consequently a high cost proposition. Also the staff in rural branches of commercial banks lack sufficient motivation to work in the rural areas for various reasons, both monetary and non-monetary.
Therefore, supervision of rural advances has come to be neglected. As a consequence, the overall recovery by commercial banks in respect of their direct advances to agriculture as at the end of June 1987 was 57.4 per cent. Their recovery under IRDP was even smaller at 45.3 per cent.

The overall profitability of the commercial banks has been under strain for some time due to rise in the cost of deposits, declining yield on advances, rise in establishment expenses etc. Losses on account of rural business of commercial banks have been contributing to their overall losses. Low interest rates on agricultural advances, lendings under IRDP, relatively poor deposit mobilisation in rural branches lower staff productivity, etc., have contributed to the poor profitability of rural business. As rural lending has been found contributing to losses, cross-subsidisation has become necessary raising the cost of credit to the non priority sectors.

The committee concludes that if commercial banks are to emerge as a strong system to be able to serve credit effectively and efficiently in the rural areas, the targets for financing weaker section and the rural poor should be reasonable, such as the system can bear.

Coming to RRBs, the committee points out that, in setting up the RRBs in 1975, the intention was to create an institution which combined the local feel and familiarity with the rural
problems which the co-operatives possessed and the degree of business organisation and modernised outlook which the commercial banks had. Partnered by GOI, State Government and sponsor bank in the equity ratio 50:15:35, these new banks were conceived as low cost district banks exclusively to meet the credit needs of the target group, i.e., small and marginal farmers, agricultural labourers, artisans and other rural residents of small means. But the RRBs have belied the basic assumptions of the Working Group on Rural Banks (1975). There has been near-parity in pay scales between commercial banks and RRBs. The local feel thought to be brought in by RRBs through their staff was not found to be same as in co-operatives. As on June 1986, the recovery of RRBs was 49 per cent of demand. Wilful defaults, misuse of loans, lack of follow-up, wrong identification of borrowers, extension of benami loans, staff agitations, etc., contributed to the poor recovery in the RRBs. Add to this the fact that their lendings were exclusively to weaker sections, at low interest rate margins and high operating cost involved in handling small loans with no scope for cross-subsidisation. In consequence, there has been a steep decline in their profitability, poor recoveries and problems relating to management and staff. Out of the total of 194 RRBs in 1986, the number of RRBs working at loss was 148. The accumulated losses in respect of 157 RRBs at the end of
December 1986 amounted to Rs.100 crore and these had wiped out the entire share capital of 117 RRBs as on that date. It will be only fair to say that weaknesses of RRBs are endemic to the system and non-viability is built into it. In the circumstance, the RRBs would not be able to serve the interests of the target group in the manner expected of them.

The committee concludes that there can be no place for the RRBs in the country's rural credit system for the future and that they should be merged with the sponsor banks. The committee does not see that this will only add to already unbearable burden on the commercial banks. The committee is of course right that if lendings to rural and weaker sections are to be at concessional rates, there has to be some cross-subsidisation. But the cross-subsidisation does not have to be within each institution or even within each component of the total system. As the committee elsewhere says, all that is needed is that the system consists of two segments, a larger segment responding to the market forces and operating side by side with a smaller, poorer, and hence protected segment and that the latter is within the absorbable capacity of the total system. Infact, if two segments are kept separate, it may help to avoid leakages and give greater transparency to concessions and subsidies so that one knows who is paying for him and how much.

The committee confirms the major weaknesses of the co-
operative system which umpteen previous committees, and working groups, have pointed out; namely, neglect of the base level institutions, with the lower tiers looking up to the higher tiers for refinance at all levels while higher level institutions look after their own interests often at the cost of the primaries. The committee emphasises that the essence of basic features of co-operative banking system must be a larger reliance on resources mobilised locally and lesser and lesser dependence on higher credit institutions. Heavy dependence on outside funds has, on the one hand, made the members less vigilant, not treating these funds as their own, and on the other, led to greater outside interference and control. Overall, this has made the cooperatives a mediocre, inefficient and static system. This is of course true, but while reiterating it, the committee forgets its own revelation, namely, that the vitality of the rural financial institutions depends on the vitality of the economy and the activities pursued by the borrowers. The fact is that agricultural credit co-operatives are essentially co-operatives of the borrowers and there is hardly any scope for raising resources except by coercive procedures.

Co-operation in India has been both state sponsored and state patronised. That was one of the basic tenets of the RCS committee 1954. As already noted, 15 years after, the Rural
Credit Review Committee in its report 1969, admitted that the Integrated Scheme of Rural Credit envisaged by the RCS committee with state participation at every level of the co-operative structure, had not been pursued or implemented vigorously in all the states; this was only a polite way of saying that it had failed. The Khusro Committee has elaborated on this failure. It points out that the powers which vest in the Government under the co-operative law and rules are all-pervasive and the state has come to gain almost total financial and administrative control over the co-operatives, in the process, stifling their growth. Some of the unhealthy results of politicisation are interference in the recovery of co-operative dues or promise to write off the dues if elected to power, and determination of interest rates on considerations other than financial returns, i.e. with an eye on populist appeal. Such actions generate a general psychology of non-repayment, vitiating the recovery climate and jeopardising the financial interests of credit agencies. Besides, mass supersessions are resorted to on political considerations. Paradoxically, State partnership which was conceived as an effective measure for strengthening the co-operative credit institution has paved the way for ever-increasing state control over co-operatives, culminating in virtually depriving the co-operatives of their democratic and autonomous character effective non-official leadership along with democratic management has
disappeared altogether. The time has come to reverse this process.

But, evidently, the committee did not think that the time had come to reverse the process of creating new institutions. It argued that the state apexes in credit sector and the other larger co-operative banking systems with all-India jurisdiction have yet no national bank of their own to function either as a national balancing centre of the surpluses of the state systems or the larger co-operative enterprises; these functions are today done in some areas perfunctorily and in others (such as deposit holders), effectively by the commercial banks. Only national apex co-operative bank could fill the systemic gap and hopefully help build the systemic strength and cohesiveness which stems from a union of the state apexes. Hence, the committee recommended the establishment of a National Co-operative Bank of India.

1.8 FINANCIAL SECTOR REFORM

An integral part of the Government's agricultural adjustment programme is the reform of the financial system. The high priority accorded to it is clear from the fact that within months of its assuming office, the Narasimha Rao Government directed the appointment of the committee on the Financial System, requiring it to submit its proposals within 90 days. Besides
making recommendations to ensure the efficiency, effectiveness, accountability and profitability of commercial banks and financial institutions, the committee was asked to advise how "greater competitive vitality" could be infused into the system, so as to make it "respond more effectively to the emerging credit needs of the economy". These terms of reference do not limit the committee's enquiry to any particular sectoral credit need, but cover the economy as a whole. However, for better or for worse, the committee has confined its attention to the industry and export sectors. Neither co-operative credit institutions nor Land Development Banks figure in its purview; and rural credit is mentioned only in the context of rural branches of commercial banks and Regional Rural Banks.

By and large, the committee takes the view that rural branches of commercial banks are unremunerative' and that the Government's policy of requiring banks to provide 40 per cent of their advances to priority sectors has been a drag on their viability. On these premises, its recommendations tend towards a progressive disinvolve ment in rural credit for commercial banks, and a diversification of the business of Regional Rural Banks (RRBs). The former is sought to be achieved partly by avoiding further extension of the rural branch network; and partly by segregating rural business and setting up rural banking
subsidiaries, functioning under the purview of NABARD, more or less like RRBs.

1.9 NABARD STUDIES

National Bank for Agriculture and Rural Development (NABARD) launched field studies in nine states to gain perception into the problems of delinquency in loan repayment from the demand side. The demand side studies were carried out in two states (Punjab and Kerala) with good recovery performance and seven states (Bihar, Gujarat, Karnataka, Madhya Pradesh, Maharastra, Tamil Nadu and West Bengal) with poor recoveries. The magnitude of overdues was higher in the case of investment credit (term loans) than in the case of crop loans. A considerable proportion (30 to 40 per cent) of the default in the case of investment credit extended by Primary Land Development Bank (PLDBs) was over five years old. Whereas in respect of crop loans borrowed from primary Agricultural Credit Societies (PACS) it was less than two years old. The supply side studies carried out in five states examined the impact of faulty lending and recovery procedures followed by land development banks.

1.10 STUDIES ON COOPERATIVE OVERDUES

Dadhich and Kalyankar concentrate on the recovery performance of PACs and measure the extent of overdues and account for their causation in Rajasthan and Parbhani district of
Maharashtra. Dadhich finds that there was no relationship between landholding and repayment, literacy and repayment, volume of borrowing and repayment. However, he finds that borrowers with irrigation facility, growing cash crops, using chemical fertilisers, depending mainly on cultivation, and belonging to middle class, defaulted less compared with their counterparts.

Kalyankar reports that overdues accounted for 55 per cent of total outstandings and the 'r' between overdue and annual rainfall was negative. He finds that the level of overdues increases with the proportion of loan conversion and the density of borrowing membership inversely related to loan overdues. Cropping intensity, area under irrigation and proportion of cash crops to total cropped area were negatively associated with overdues. A positive relationship between overdues and landholdings and family consumption expenditure was established. 80 per cent of the total volume of overdues was defaulted by the wilful defaulters. Lower the operational size of holding, higher was the probability of becoming a non-wilful defaulter.

Datey Team\textsuperscript{13} launched field studies in 5 states to obtain the causes and trends of overdues at Primary Agricultural Credit Society (PACS) and Central Bank level. About one-third of the total number of Central Banks in the country were studied for the purpose. At the society level with the objective of bringing out
principally the relationship between the size of holdings of the borrower and the levels and trends of overdues information was collected from over 36,000 borrowers of as many as 233 PACS on a countrywide basis, of which over 29,000 were defaulters. Of these, 133 societies broadly at the rate of three societies per district from any three districts and societies are purposive. Special studies have been undertaken in regard to recovery performance area-wise and the effects of procedure followed by processing/marketing agencies in routing credit through them.

The overdues of Central Co-operative Banks formed 36 per cent of the loans outstanding as on June 30, 1972. The overdues of PACS formed as much as 44 per cent of the outstandings as on June 30, 1972. The team grouped the causes of overdues into two categories viz., external factors which might be said to be beyond the control of the lending institutions, for example, climatic conditions, irrigation facilities and cropping pattern and internal factors such as presence of full time paid secretary, arrangement of supervision and volume of business of society. There is a positive relationship between overdues and internal factors but not external factors. All categories of farmers behave more or less alike in the matter of repayment of their dues on time. Members of Managing Committee of Societies, Directors of the Central Banks have shown general apathy in the matter of recovery of loan. Lack of will and discipline among
cultivators to repay are the principal factors responsible for the prevalence of overdues in the co-operatives. Defaulters of co-operative societies were financed by some of the state Governments through Taccavi loans. Some of the governments have written off such loans on a large-scale.

Owing to various administrative failures, several indebted members of PACS did not receive the benefits of conversion even in the years of natural calamity and have continued to be defaulters and thereby became ineligible for further credit facilities from the societies. This has aggravated the problem of overdues at the higher levels of the structure affecting thereby the free flow of credit for the agricultural development programmes in their areas. If the non-wilful defaulters were to be provided with relief as well as fresh finance, quick action has to be initiated. Small Screening Committees should be set up at taluk level or co-operative Central Bank level for identifying the defaulters eligible for relief. It should be done with the utmost care and vigilance. None of the wilful defaulters should get any relief

1.11 STUDIES ON CREDIT REQUIREMENTS AND DELIVERY PATTERNS

The pattern of credit requirement was analysed in detail in the NCAER report,14 "Credit Requirements for Agriculture". A study in depth of what actually happens in the villages in the
matter of agricultural credit should, therefore, be of considerable practical interest. The factual basis of this study was comprehensive field survey of 3,309 cultivating households of which 1,306 were borrowing households. The sampling was done with as much scientific rigour as circumstances permitted, with suitable oversampling in more developed areas. The analysis clearly brought out that a major gap existed in the sphere of investment credit and considerable progress had to be made in respect of long term financing of agriculture through institutional agencies i.e., primarily the co-operative land development banks.

Another finding of the study was with greater institutionalisation, the rate of interest on loans from all sources showed a decline. Farmers in 1970-71 could fulfil about 29 per cent of their credit requirements through funds obtained at 8-10 per cent interest, about 23 per cent at 18-24 per cent interest and about 19 per cent free of interest. The average rate charged by private agencies was 22 per cent which was much lower than what it was prior to Independence. However, owing to their heavier reliance on non-institutional sources of credit, the average interest cost of borrowing (16 per cent) for the smallest category of farmers i.e., upto 2 hectares was much higher than that (9 per cent) of the largest categories i.e., about 6
hectares) of farmers. In respect of long term development financing the cooperative agencies are still not playing an important role, accounting for only about one fifth of the total disbursement of credit. However, there has been a notable change in the advances portfolio of the land development banks consequent upon a reorientation of their lending policies toward developmental finance.

Ashok Kumar\textsuperscript{15} et al. studied the growth and disparity in agricultural advances by commercial banks and the study reveals that there is an increased demand for credit as a result of adoption of new agricultural techniques to maximise the agricultural production. To cater to these credit needs the commercial banks have extended banking facilities in rural areas and enhanced the advances for agricultural sector. This study examines the expansion of commercial banking facilities and the extent of nature of disparity in flow of credit in different states. The study covers the post nationalisation period from 1969 to 1982 and the data are collected from publications of RBI and Directorate of Economics and Statistics, Ministry of Agriculture.

The study revealed that the expansion of branches of commercial banks was more in rural areas when compared to semi-urban and urban areas. Rural Bank branches recorded a growth rate of 15.6 per cent, whereas semi-urban branches and urban
branches recorded a growth rate of 7.6 per cent and 9.3 per cent respectively.

The expansion of rural bank branches was maximum in Orissa i.e., 25.8 per cent followed by Bihar 24.8 per cent, Jammu and Kashmir 20.7 per cent, West Bengal 19.7 per cent, Uttar Pradesh 18.7 per cent, Madhya Pradesh 18.2 per cent, Assam 17.7 per cent, Andhra Pradesh 16.7 per cent and Haryana 15.7 per cent. States such as Himachal Pradesh, Rajasthan, Maharashtra, Tamil Nadu, Punjab, Karnataka, Kerala, and Gujarat experienced a growth rate of the rural bank branches which was below the national average. More branches were opened in the states which were agriculturally underdeveloped. The compound growth rate of agricultural advances at the national level was 26.6 per cent and the growth rates in all the states were positive and significant. Himachal Pradesh recorded the highest growth rate i.e., 87 per cent followed by Jammu and Kashmir 69 per cent, Orissa 53 per cent, Bihar 44 per cent, Punjab 41 per cent, Assam 37 per cent, Madhya Pradesh, Rajasthan and Haryana 35 per cent each, West Bengal 32, and Kerala and Uttar Pradesh 28 per cent each. It was observed that in 1969, the maximum per hectare credit was Rs.77.29 in Tamil Nadu and the minimum was in Jammu and Kashmir Rs.0.11 paisa as against the national average of Rs.16.77 per hectare. In 1982, Tamil Nadu recorded maximum flow of credit i.e., Rs.748.58
per hectare and the minimum of Rs.69.44 per hectare was recorded in Assam indicating a wide variation in the flow of credit between the states. It was observed from the result of Gini concentration ratios that there was a decrease in disparity in the distribution of bank advances in all the states over the period of study.

S.R.Mehrotra's study, "Institutional Agricultural Credit with Special Reference to the Needs of Small Farmers in Rajasthan" which was based on both published and field data, found significant increase in correlation coefficient between cooperative credit per hectare and food grains production per agricultural worker from pregreen revolution period to green revolution period. Similarly, the study has found positive correlation between agricultural credit disbursed by the credit institutions and other indices of agricultural growth. Wide variations in the performance of PACs were explained away in terms of irrigation facilities, use of fertilisers and modern implements and greater area under cash crops. The study brought to light tardiness of SFDA/MFAL projects to stimulate flow of institutional credit to target groups, heavy reliance of small farmers of all regions of the state of Rajasthan on private agencies for production credit. Using linear programming model the study substantiated the hypothesis that the availability of working capital at reasonable interest rates was a major
constraint in farming operations.

Balishter and Singh, Roshan\(^{17}\) made an attempt to investigate the impact of commercial bank finance on income and savings of the farmers with the following objectives:

1. To examine the extent of availability of credit to the farmers;
2. To identify the existing credit gap;
3. To examine the pattern of credit utilisation; and
4. To assess the impact of farm credit on the level of income of farm families and their savings mobilised by the commercial banks.

Four villages from Bichpuri block of Agra district, Uttar Pradesh were selected for the study. A total of 96 bank-borrowing farmers consisting of 41 marginal, 36 small, 11 medium and 8 large farmers constituted the sample. Data for the year 1983-84 were collected through survey method.

It was observed that 18 farmers out of 96 borrowed from commercial banks as well as co-operative banks and 31 farmers had borrowed from commercial banks and also from non-institutional agencies like moneylenders, traders, relatives, and friends. The percentage of farmers borrowing from non-institutional agencies was inversely related to farm size. The total credit available per farm came to Rs.1827, out of which the share of institutional
agencies was 86 per cent. Commercial banks accounted for 82 per cent of the total loan available to the farmers whereas the share of cooperatives was only 12 per cent. Per hectare availability of credit from commercial banks was the highest on marginal farms and the lowest on large farms. 63 per cent of the total loan from commercial banks was availed of for short-term crop loan, about 17 per cent for purchase of farm animals and about 8 per cent for purchase of other farm equipment. The credit gap was Rs.592 per farm on an average for the 96 farmers which was 24.48 per cent of the credit requirements. The percentage of credit gap was 4,11,25 and 38 in case of marginal, small, medium and large farms respectively. About 82 per cent of the available loan was utilised for productive purposes whereas 18 per cent was diverted to unproductive purposes. Farm credit had a positive impact on income from the farms of all sizes. Out of the average net saving of about Rs.728 per farm only Rs.208 i.e., 28.56 per cent was deposits. The percentages of savings on small, medium and large farmers were 14.92, 26.34 and 29.17 respectively whereas there was no saving on marginal farms. Adequate provision of credit by commercial banks, proper supervision of credit utilisation and mobilisation of savings are suggested to achieve better results.

Gadgil\textsuperscript{18} in his paper on "Agricultural Credit in India : A
"Review of Performance and Policies" describes the production-oriented system of lending. According to him a production-oriented system of lending imposes credit widening as also credit deepening. He has made an attempt to examine the said issues empirically, the extent to which the two processes have occurred over the period 1973-74 to 1982-83 for which he used the data of three All India Debt and Investment Surveys of 1961, 71 and 81. The share of formal credit in the total outstanding cash debt of farmers has improved dramatically from 18 per cent in 1961 to 63 per cent in 1981. Consequently, the moneylender's share in the total debt has gone down from 62 per cent to 16 per cent. However, the proportion of farm families reporting indebtedness to institutional credit agencies has declined marginally over the two decades from 15 per cent to 13 per cent, which supports the view that the credit widening has not been satisfactory.

H.S. Shylendra's paper attempts to study as to how far the RRBs could succeed as an institutional reform in the field of rural credit, and in what way their policies have been different from those of the other institutions so as to enable the rural poor to have better access to institutional rural credit. These objectives have been examined here with reference to the functioning and performance of an RRB in Karnataka, namely Tungabhadra Gramin Bank (TGB). The TGB is the first RRB to be set up in South India in 1976. It serves the districts of
Bellary and Raichur with a network of 163 branches. The objectives of this study have been fulfilled mainly by analysing the nature of the selected RRB's lending policies and practices and the pattern of distribution of its loans across different sections of the society. Along with the analysis based on data at a point of time on the distribution of credit across different households, the performance of the selected RRB is also tried to be assessed in a much more dynamic way by examining the regular or sustained access of the rural poor to it. While the lending policies of the RRB have been examined mainly by going through its annual reports and other published and unpublished records, the analysis of the distribution pattern of its loans and regular access is based on the data derived from the survey of 197 randomly selected borrower households of the TGB. These borrower households have been selected in such a way as to represent not only the different loan purposes/schemes/categories but also the different agro-economic regions of the district. While the information about the borrowings of the sample households has been obtained from the loan ledgers, the socio-economic details have been collected through the household survey conducted during 1989.

The RRB though meant basically for the poorer sections was found to have benefited mainly the households belonging to the
better-off segments of the rural society. Not only the major portion of the RRB's loans had gone to the better-off households but even the regular accessibility to the bank was found restricted mainly to them. This is found attributable to the emphasis put by the RRB on the security-based lending. The system or practice of considering the individual and not the household as the borrowing unit had not only enabled the richer sections to borrow from the RRB in the name of rural poor but also had helped them to garner a major share of its loans. Though the bank had brought in a considerable number of poorer households into its ambit, their coverage is attributable more to the selection of such households by the government agencies under various poverty alleviation schemes rather than to bank's own initiative. Incidentally, most of them have also not been able to sustain their access to the bank. As a result, the RRB was found to be serving mainly the better-off section who unlike the poor are able to sustain their dealings with it.

Even though the above results pertain to a particular RRB, given the common lending policies pursued by the RRBs in the country, the following few inferences may be drawn. The RRBs which were thus created as institutional innovation for the rural poor however did not come out with any radically different policy or strategy to reach out to their clientele. Unlike the Grameena Bank of Bangladesh, the RRBs in India have followed mainly the
established security-based lending and hence, their success as an institutional innovation/reform appears to be of a limited nature only. Since their basic policy has remained the same, the outcome was in no way significantly different from that of other institutions like the co-operatives and the commercial banks. This suggests that what is also important for serving the rural poor by the formal credit agencies is not their form but their policies to be reckoned with any institutional credit reform policy for the rural poor. The emphasis being laid currently on the innovative self-help group-based lending to help supplement the institutional credit agencies to reach the rural poor effectively is no doubt the result of such a reckoning.

B.D. Reddy's study is divided into two parts and eight chapters. The first part consists of four chapters and the second part the remaining ones. The opening chapter is on methodology. The scope of the investigation, the source of data, their statistical treatment and limitations, inter alia, are outlined in it. The multifarious aspects of interaction between agricultural development and financial intermediation are presented in the second chapter. The analysis, although mostly based on the empirical material of the Third World, is quite general, essentially theoretical and therefore has worldwide implications. The third chapter focusses on the performance of
commercial banks in agricultural finance in India with particular emphasis on the developments in the field during 1970s.

The second part starts with the fourth chapter devoted to an appraisal of the role of commercial banks in farm finance in the district of Nellore against the backdrop of its agricultural economy. The fifth chapter explores the nature of the credit market in both delta and non-delta region of the district. The type of credit market that confronts the different categories of cultivators and the imperfections thereof are also discussed. The major hypothesis, has been put to test and rejected in it. The concentration of bank credit amongst the different size groups of farmers is examined in the sixth chapter with the aid of well known measures of concentration and skewness. The seventh chapter discusses the variations in bank lending, supervision and recovery performance in respect of sample banks. The last chapter contains a summary of the study as also the underlying policy measures that could be taken by the state to ensure rural development without tears.

G.L. Karkal, et al. 21 in their paper discuss the meaning, nature and scope of scientific and systematic evaluation. Further the authors take up a few evaluation studies conducted by the banks to give a comparative picture of the research methodologies, scope and objectives and finally feed back of bank officers regarding their perception of adequacies or inadequacies.
in those studies. The paper reveals that though many studies have listed a number of objectives most of them have not attempted properly to study those objectives. The sample selection was biased as those borrowers who had disposed off their assets were not included in the study. There was no attempt to find out the comparative picture of pre-loan and post-loan status of the borrowers in the design of most of the studies. The selection of the control group for comparative study was not proper.

THE PRESENT STUDY

Although there are several studies dealing with different dimensions of the problem of rural credit, the studies on comprehensive coverage of the rural banking system are limited at the local level. This study aims at filling this gap with reference to the study area namely Kavali division of Nellore district.

a) Objectives

Specific objectives of our empirical study are:

1. To describe the institutional credit delivery system of the four sampling units.

2. To estimate the demand for credit by sample households.

3. To examine the sources, size and cost of credit.

4. To evaluate the impact of formal and informal credit.
5. To analyse the nature and estimate the magnitude of overdues of institutional credit.

b) Hypotheses

1. The structural characteristics of the credit delivery system are agency neutral.

2. The demand for credit does not vary significantly across size groups and categories.

3. The sources, size and cost of credit do not differ significantly across borrower households.

4. There is no significant variation in the impact of formal and informal credit on different size groups.

5. Overdues are not agency and size-neutral.

SAMPLING FRAME AND SAMPLING UNITS

A Selection of Borrower Households: For the purpose of empirical investigation Nellore district has been purposively chosen out of the 23 districts of Andhra Pradesh. Further, of the 3 revenue divisions, Kavali division has been purposively selected as it represents the characteristics of the district. Any district or division is not a homogeneous unit like the country. The geographical and agro-climatic conditions differ significantly. With a view to analysing the rural economy of the division, we
have classified the revenue mandals into two categories, namely delta and non-delta. One mandal from each segment is chosen randomly. Kovuru from the delta segment and Duttalur from the non-delta segment figure in our study. Leguntapadu village from Kovuru and M.Naidu palli village from Duttaluru mandal are randomly selected. The borrower households in the two villages are stratified according to size of the landholdings and a sample of 20 per cent of total borrower households from each size group was selected. Table 1.1 provides particulars of the stratified selection of our sample households.
<table>
<thead>
<tr>
<th>Size group (Acres)</th>
<th>Mandal village</th>
<th>Kovuru Mandal village</th>
<th>Duttaluru Mandal village</th>
<th>Selection of Sample at the Village Level</th>
<th>Total</th>
<th>Total sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marginal farmers (0 - 2.5)</td>
<td>115</td>
<td>23</td>
<td>89</td>
<td>18</td>
<td>204</td>
<td>41</td>
</tr>
<tr>
<td>Small farmers (2.5 - 5.0)</td>
<td>113</td>
<td>23</td>
<td>64</td>
<td>13</td>
<td>177</td>
<td>36</td>
</tr>
<tr>
<td>Medium farmers (5.0 - 10.0)</td>
<td>104</td>
<td>20</td>
<td>46</td>
<td>9</td>
<td>159</td>
<td>29</td>
</tr>
<tr>
<td>Large farmers (10.0 and above)</td>
<td>32</td>
<td>6</td>
<td>17</td>
<td>3</td>
<td>49</td>
<td>9</td>
</tr>
<tr>
<td>Agricultural labourers</td>
<td>163</td>
<td>33</td>
<td>34</td>
<td>7</td>
<td>197</td>
<td>40</td>
</tr>
<tr>
<td>Rural artisans and others</td>
<td>44</td>
<td>9</td>
<td>11</td>
<td>2</td>
<td>55</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>571</strong></td>
<td><strong>114</strong></td>
<td><strong>261</strong></td>
<td><strong>52</strong></td>
<td><strong>832</strong></td>
<td><strong>166</strong></td>
</tr>
</tbody>
</table>
SELECTION OF INSTITUTIONAL CREDIT AGENCIES

For the study of institutional credit agencies we have confined ourselves to the RRB covering the district namely Pinankini Grameena Bank (PGB) and the Primary Agricultural Credit Societies (PACS). Since it is impossible for any individual scholar to spread his net on a wider canvass he has to restrict his sample to two branches of the PGB, choosing one from the delta and the other from the non-delta division. Similarly, in respect of the PACS he has to randomly choose one from each segment of the division.

Thus, the sampling frame consists of 2 sets. In the first set we deal with 166 borrower households. In the second set we investigate the structure, conduct and performance of the two branches of the PGB and two PACs.

DATA BASE

The structure of any empirical study is based on its relevant data. The present study naturally draws on the published data from a multiplicity of agencies - national and international, official and non-official. The publications of the RBI, the SBI and the rest of the banking system provide a valuable source of data for any study dealing with rural banking and financial system. Ours is not an exception. The publications of the Government of India such as the budget
documents, economic survey and statistical abstracts constitute an indispensable source. The district manuals and abstracts provide a wealth of information as also the annual reports of agencies like the DRDA. More often than not the problem is to choose the data from the right agencies and restrict it to manageable limits. The primary data are drawn from our sample units with the help of a structured schedule. Canvassing a structured schedule among the rural households is an education by itself. It is rather impossible to elicit reliable information without cross checking it from the local functionaries and elders. It was possible for the researcher to get the cooperation of the people concerned because of continuous and sustained efforts made sometimes leading to situations of desperation. The sole objective was to draw reliable data as they constitute the foundation of any structure of empirical study.

ANALYTICAL TOOLS, TECHNIQUES AND LIMITATIONS

Raw data by itself may not and will not serve the purpose on hand. Data processing and analysis are the logical steps. Analytical skills and statistical tools provide the sophistication that is needed to draw meaningful conclusions. The popular descriptive statistical measures are liberally employed. Advanced statistical tools are sparingly used due to the limitations of the scholar in this regard. Description,
which is the traditional as well as the modern tool is resorted to with all the power that goes with it. In the case of field investigation historical data could not be generated and, therefore, historical method could not be adopted. However, in respect of the secondary data the time series analysis is made use of in addition to cross sectional analysis. We do not venture to generalise our conclusions as they are area-specific as well as time-specific.

CHAPTER SCHEME

The thesis is organised into seven chapters. The opening chapter is an exploration into the select review of literature and an explanation of the methodology adopted. The second chapter probes into the evolution and the present status of rural banking in India. A brief profile of the sampling units starting from the district to the villages is attempted in the third chapter. The structure, conduct and performance of the rural banking system in the district based on field data is described in chapter four. The demand for and supply of credit and its structure are explored in the fifth chapter. The sixth chapter is concerned with the structural dimensions of the problems including the question of overdues. The last chapter presents a summary of findings and conclusions.
REFERENCES


7. RBI: *All India Rural Credit Survey*, Bombay, 1954


