ANNEXURE - I

INSTRUMENTS OF RURAL CREDIT STRUCTURE IN INDIA

I. NON-INSTITUTIONAL SOURCES:

A) Money-Lenders:

For a very long time, the rural credit scene has been dominated by the village money-lenders. They can be either agriculturist money-lenders who combine farming with money lending or professional money-lenders whose only occupation is money-lending. The money-lenders reside in villages and so have local knowledge and experience. They are easily accessible round the clock and maintain close and personal contact with the borrowers. They supply credit for both productive and non-productive purposes against mortgage of land as well as against promissory notes. Their methods of business are simple and elastic. Unlike institutional credit which, in quantitative terms, is not sufficient to cater to the needs of farmers, "the money-lender's capital is a reserve on which the peasant families can draw in times of individual and collective stress."¹ Darling summarised the reasons underlying money-
lender's continuance as a source of rural finance. In this context, Dr. Pratap Singh\textsuperscript{2} underscores Darling's observation that "he is always accessible, even at night; dispenses with troublesome formalities, asks no inconvenient question, advances promptly and if interest is paid, does not press for repayment of principal. He keeps in close personal touch with his clients and in many villages shares their occasions of weal or woe. With his intimate knowledge of those around him, he is able, without serious risk, to finance those who would otherwise get no loan at all." These factors enabled the money-lender to get entrenched firmly in rural credit structure though his share in total agricultural credit has been on the decline over decades.

The omnipresent village money-lender has been caricatured as the villain of the peace in any analysis of rural poverty.\textsuperscript{3} And obviously so for the various malpractices adopted by him, like the demand for advance interest, demanding a present for doing business and general manipulation of accounts to the disadvantage of the debtors.\textsuperscript{4} He charges high rates of interest, gives no receipts for repayments and often denies such repayments. He obtains bonds and promissory notes, takes the thumb impressions of the debtors on blank papers and enters in them sums larger than actually lent.\textsuperscript{5} Besides, he seldom cares about the use of money he has lent and frequently encourages his clients to continue borrowings as long as the latter could give additional security. He advances loans mostly for short periods in order to maintain a high liquidity and also tries to secure a partial or even complete monopoly in the field.\textsuperscript{6} The cumulative effect of all these malpractices practised by money-lenders is that debt once contracted keeps on accumulating.\textsuperscript{7} The debtor's position can verily be that of a fly caught in a cobweb, unable to come out. The debtor-farmer is forced to sell away his land partly or wholly to clear off the debt and gradually is reduced to the position of an agricultural labourer.

\textbf{B. Traders and Commission Agents:}

They supply funds to farmers for productive purposes particularly in case of cash crops like cotton, groundnut, tobacco etc., and in the case of fruit orchards, like...
mangoes. They, however, insist their debtors to sell their produce immediately after harvest when the prices are low and also charge heavy commission. They also charge exorbitant rates of interest and so can be bracketed with money-lenders.

C. Relatives:

Farmers generally borrow either in cash or in kind from their own relatives. Such loans are small in amount, carry low or no interest and contracted in an informal manner to tide over temporary difficulties. This source is however uncertain.

D. Landlords and Others:

Farmers of small means also borrow from landlords and others to meet their financial requirements. However, landlords like money-lenders charge exorbitant interest rates, cheat the farmers, appropriate the lands of debtors and force the farmers to become bonded slaves.

The Report of the All India Rural Credit Survey admirably summed up "Private Credit, generally unsuitable, is wholly unsuitable in the context of planning for larger production."

II. INSTITUTIONAL SOURCES OF CREDIT:

The existing Institutional set-up for Rural Credit in India is presented in Chart - A.

A. Cooperatives:

The first organised step to institutionalise credit and thereby eliminate the stranglehold of the moneylenders on the peasants saw the emergence of Cooperative Credit Societies on the horizon of rural credit. In 1883, Sir Henry Stork strongly advocated cooperative credit in India and during 1887 Sir Raymond West wrote a series of articles in 'Times of India' suggesting similar measure. The success of "land banks" organised by Mr. Wilhelm Raiffeisen in Germany made the Government of Madras to realise their suitability and vast potential and to appoint in 1892 Sir Fredrick Nicholson to study their various aspects. The study report and recommendations of
CHART - A
EXISTING INSTITUTIONAL SET UP FOR RURAL CREDIT IN INDIA

Reserve Bank of India*
National Bank for Agriculture and Rural Development*
Commercial Banks

State level
District level
Taluk level
Primary level

Branches of State or Primary Land Development Banks

Beneficiaries
Farmers with special emphasis on coverage of the small and marginal farmers, agricultural labourers, rural artisans and those engaged in productive activities in rural areas.

* Refinancing Agencies.
Nicholson initiated the Government of India to appoint a Committee under the Chairmanship of Sir Edward Law in 1901 and on the basis of its recommendations, a bill was drafted, introduced and passed on 25th March, 1904. Established through the Cooperative Societies Act of 1904 and modified through similar Act of 1912, the Cooperatives, based on the principle of "self help and mutual help", intend to provide cheap credit to the needy farmers. In the words of Draft Fifth Plan, "Cooperation represents institutionalisation of the principle and impulse of mutual aid. It has the merit of combining freedom and opportunity for the small man with the benefit of large scale management and organisation. Cooperation is therefore conveniently suited to bring about the desired socio-economic changes in the context of the existing conditions in the country. In India, cooperation has developed and is being developed as a synthesis of a state and non-state action which has acted essentially as a constructive instrument for economic and social development. The expansion of cooperatives in India in all directions both vertically and horizontally embracing wider and wider fields of action has made it a unique in the world, an unparalleled and unknown in any single country.

The short term cooperative agricultural credit system is a three tier pyramidal system consisting of an apex body at the State level called State Cooperative Bank, intermediary structure at the district level called District Central Cooperative Banks and the primary units at village level called Primary Agricultural Credit Societies.

A Primary Agricultural Credit Society can be started by ten or more persons of a village and even the poorest can become its members as the value of each share is generally nominal. However, the members have unlimited liability. Its management is honorary except for a paid accountant or Secretary. While each member is fully responsible for the losses of the society, the profits earned by a society are not distributed as dividend to the share holders, but used for the welfare of the village. The share capital, reserves, deposits from members and general public and borrowings from D.C.C. Banks constitute the source of funds for these societies. Loans
advanced by these societies have increased from Rs.23 crores in 1950-51 to Rs.200 crores in 1960-61 and further to Rs.4196.60 crores by 1988-89. There were 87938 Primary Agricultural Cooperative Credit Societies in India with a membership of 81.24 million covering 98 per cent villages. Verily, it is now considered as an emerging sector in India. While these societies are expected to mobilise deposits from rural public for building up internal resources for financing their operations, it is observed that they have generally failed in this task.\textsuperscript{11} Further, even the District Central Cooperative Banks and State Cooperative Banks have failed to mobilise deposits and have become just channels for routing the loans and advances of Reserve Bank of India and now National Bank for Agriculture and Rural Development to the Primary Societies.

Credit made available by Cooperatives had been cornered by politically influential and richer sections of rural agricultural community. The Review Committee observed that "the proportion of small cultivators who are beneficiaries of cooperative credit is relatively low and that the big cultivators received a large share of cooperative credit than would appear to be justified."\textsuperscript{12} Wali\textsuperscript{13} also observed that the left out ones from the sphere of cooperatives are rural poor, small and marginal farmers, landless labourers and artisans.

The various Committees which examined the functioning of credit cooperatives opined that the Cooperative movement had been dominated by small groups of rich farmers and other vested interest groups who had been controlling and manipulating societies for receiving undue benefits for themselves, while the poor received only a fraction of the credit from the societies. Even in these cases, the funds were not disbursed at right time, nor were they of right amount for viability of activity, nor were they of right type. A "Study Team on Overdues of Cooperative Credit Institutions" constituted by Reserve Bank of India in 1972 observed in its Report submitted in 1974 that "lack of will and discipline among the cultivators to repay loans was the principal factor responsible for the prevalence of overdues in cooperatives."
Defective lending policy pursued by cooperatives, the apathy of management in taking quick action against recalcitrant members and absence of favourable climate were other contributory factors. Apart from these common factors normally responsible for a high level of overdues, intervention of external forces such as loan waivers, concessions in various forms towards repayment of principal and repayment of interest had also affected the recovery performance of credit institutions to a significant extent. Apart from weakness of inadequate understanding of moral and philosophical meaning or principle of cooperative movement by people and inadequate or mismanagement of societies, they also suffer mostly from politicisation.

Farmers, particularly small and marginal farmers, are not adequately supplied with credit for all their needs. It was observed by Sri M. Narasimham that the small and marginal farmers and agricultural labourers did not receive their proper share in the credit and other facilities extended by the cooperatives. As a result, they are forced to go to money-lenders who therefore seem to be co-existing with primary societies in the same areas.

There is again another problem of uneven distribution of cooperative benefits as between different states. There is spectacular progress of cooperatives in Tamil Nadu, Andhra Pradesh, Karnataka, Punjab and Himachal Pradesh while there are vast regions and areas in West Bengal, Bihar, Orissa and Rajasthan where the movement has neither spread adequately nor has taken deep roots. The membership of these societies in the entire country is only around 45 per cent of the rural families; agricultural labourers and rural artisans constituted only 10 per cent of the total membership.

The progress of cooperative credit societies in the first fifty years from 1901 to 1951 was painfully slow and they could provide just 3.3 per cent of total rural credit. The attitude of the Government towards this movement was rightly summed up by All India Rural Credit Survey (1954) which stated "in the village itself, no form of credit organisation will be suitable except the cooperative society -- cooperation has
failed, but cooperation must succeed." In view of the fact that "the primary credit society has continued to remain the weakest link in the entire cooperative structure", the Government of India and the Reserve Bank of India introduced a programme to re-organise and revitalise the primary agricultural credit societies. Non-viable societies were amalgamated with large sized multi-purpose societies formed on the basis of the recommendation of All India Rural Credit Review Committee. The National Commission on Agriculture (1971) recommended the organisation of Farmers' Service Societies to provide not only credit but also agricultural inputs and technical guidance and these societies provided for minimum share of weaker sections in membership and management. A scheme was introduced in 1970 whereby the commercial banks financed the Primary Agricultural Credit Societies. The share of cooperatives in rural credit has steadily gone up over the last two decades. Verily their progress in the last three decades is much more than the progress which was achieved in the first 60 years of their existence.

Recently, the Agricultural Credit Review Committee headed by Prof. A.M. Khusro drew pointed attention to the serious inroads made into the democratic functioning of the system by the State Governments and the lost spirit of cooperation among the cooperatives. The Committee, therefore, demanded depoliticisation and speedy revitalisation of the cooperative credit institutions at all levels of short, medium and long term credit. As a follow-up to these recommendations, the Government has decided to introduce the concept of Business Development Plans for Primary Agricultural Cooperative Societies. Each PACS is expected to mobilise adequate deposits, attract equivalent amount of institutional finance and generate a business four times in size of the deposits mobilised. It is expected that the 70000 non-viable PACS of the total 87305 will be covered by the revitalisation programme, each of the PACS reaching a minimum business of Rs.10 lakhs per annum at 15 per cent annual growth rate.19 The Government has also drafted a National Cooperative Policy (1991) which is in the process of finalisation. The Government intends to assist
cooperatives in the sphere of Human Resource Development, which is considered a strategic intervention for cooperative development by the Committee headed by Sri K.N. Ardhanareeswaran (1987).

B. Land Development Banks:

The Cooperative banking structure relating to the provision of investment credit for redemption of mortgage on agricultural land, development of farm land and discharge of other prior debts etc., as long term loans was separately in operation since 1920. The Cooperative Land Development Banks or Land Mortgage Banks as they were previously called or the Cooperative Agriculture and Rural Development Banks (ARDBs) as they are now called were organised to offer long term funds at moderate rates and recover loans in annual or semi-annual instalments spread over a number of years ranging between 5 to 15 years. These banks generally grant loans against first mortgage of agricultural property though in a few cases they may advance loans against second mortgage as well. The value of the land to be got mortgaged is assessed by its experts who are conversant with local conditions.

The long term cooperative credit structure is generally a two tier structure with Central Land Development Banks operating at State level and Primary Land Development Banks generally at Taluk level. There are considerable differences in the organisation of Primary Land Development Banks in different states while in some states the Central Land Development Bank itself does the business of primary units through its branches.

These banks obtain their funds from share capital, reserves, deposits from the public and issue of debentures or bonds, the last being the principal source. Debentures are long term loans floated by Central Land Development Banks carrying a fixed interest rate and guaranteed by concerned State Governments as to payment of interest and repayment of principal. They are subscribed by L.I.C., the State Bank of India and its subsidiaries, the Commercial Banks and by the Reserve Bank of India.
They also float rural debentures for periods up to 7 years which are subscribed by farmers and panchayats and by Reserve Bank of India. Recently, the refinance facilities provided by NABARD have helped these banks to enlarge their lending operations.

Major purposes for which investment credit provided by ARDBs are development of minor irrigation, farm mechanisation, horticulture and plantation, land development, animal husbandry, fishery, sericulture and farm forestry. Since last 4 or 5 years, these banks have diversified their operations for financing non-farm activities covering artisans and rural entrepreneurs. These help to generate employment and increasing income to rural areas. Of late, these banks have also started financing rural housing to farmers with refinance support of the National Housing Bank in order to improve the living conditions and quality of life in rural areas.

The long term lending by the Land Development Banks touched the mark of Rs. 718.70 crores in 1988-89 as against advance of Rs. 1.30 crore in 1950-51. However, even these banks are plagued by the problems of mounting overdues, lack of trained technical personnel and supervisory staff capable of shouldering the increasing volume of business and excessive obsession with security. The Agricultural Credit Review Committee has pointed out several weaknesses in the system. As a cumulative effect of the high transaction costs and administered interest rates particularly concessionality in interest rates on rural lending, the net margin on loan was negative i.e., -3.21 per cent in the case of Primary Agricultural Credit Societies and -1.00 per cent in the case of Primary Land Development Banks.\(^{21}\) Transaction costs for Primary Land Development Banks was 3.39 per cent as against 6.00 per cent for Commercial Banks and 6.90 per cent for Regional Rural Banks. Cost of funds for Primary Land Development Banks was 7.78 per cent against 7.48 per cent of Commercial Banks. However, average gross income was low for Primary Land Development Banks at 10.17 per cent as against 11.62 per cent for Commercial Banks.\(^ {22}\)

\textit{C. State Bank of India and its Subsidiaries:}
The first effort at taking banking services to rural areas was the nationalisation of Imperial Bank of India and the establishment of State Bank of India. The need for a single State agency to supply agricultural credit was felt in 1945 itself, when the Agricultural Finance Sub Committee, 1945 chaired by D.R. Gadgil emphasised "the need for a single State agency to meet the credit needs of the agricultural sector.\textsuperscript{23} Though the Rural Banking Enquiry Committee in its report in May, 1950 did not favour nationalisation of the Imperial Bank but only recommended greater Governmental supervision and control\textsuperscript{24}, it was felt that the bank failed to keep pace with the tempo of developments. A stalemate was created either to push banking into remote areas or remain stagnant was the situation.\textsuperscript{25} As the commercial banks including the Imperial Bank of India were thriving in the urban sector and were not equipped to respond to the emergent needs of economic regeneration of rural areas, the All India Rural Credit Survey Committee (1954) recommended the creation of a state-partnered and state-sponsored bank by taking over the effective control of the Imperial Bank of India which was the biggest commercial bank in the country.\textsuperscript{26} It was felt that, by nationalisation of Imperial Bank, on one hand, the surplus available in rural areas might be mopped up for the benefit of the National Economic Development\textsuperscript{27} and on the other hand, financial assistance to cooperative institutions might be provided including the provision of cheap remittance facilities.\textsuperscript{28} The Government of India introduced the State Bank of India Bill in the Lok Sabha on 16th April, 1955 which was passed by the Parliament and got the President's assent on 8th May, 1955. The Act came into force on 1st July, 1955 and the Reserve Bank of India became its major shareholder taking up 92 per cent of its paid up capital.\textsuperscript{29} As there were problems in amalgamation of State associated banks in State Bank of India, a separate Act viz., the State Bank of India (Subsidiary Banks) Act, 1959 was passed and it received the President's assent on 10th September, 1959. As a result, the State Bank took over the eight state associated Banks (viz., State Bank of Hyderabad, Bikaner, Jaipur, Saurashtra, Patiala, Mysore, Indore and Travancore) as its subsidiaries.
Thus, their separate entity was retained to enable them to serve the local needs in their respective areas.\textsuperscript{30}

The cooperative credit system was unable to meet the increasing credit demands of modernised agriculture. It is in such a situation that the role of State Bank of India which until then was mainly of a supplementary source to be applied only when needed by the cooperative sector was changed to a more positive one.\textsuperscript{31} In 1965, the Bank was permitted to finance marketing/processing cooperatives directly without obtaining clearance from the Financing Central Cooperative Banks.\textsuperscript{32} By 1968, similar thinking was coming to the surface in the field of production as well, requiring now the participation of banks for meeting the credit needs of large land holders.\textsuperscript{33}

The State Bank of India has been granting short term credit facilities to the State and Central Cooperative Banks against Government securities at a concessional rate of interest, subscribing to the debentures floated by Central Land Development Banks, granting advances on the security of such debentures and granting loans against security of warehouse receipts. It has also adopted villages, launched the Integrated Rural Development in 1977-78 on a pilot basis to bring about all round development of villages and started Agricultural Development Branches to finance agricultural development in their areas apart from financing farmers directly.

\textbf{D. Commercial Banks:}

Ever since the inception of our successive Five Year Plans, commercial banks have been financing growth sectors of the economy, particularly industries and in more appropriate words the industrialists and big businessmen - the rich sections of the society. During the period 1950-51 to 1968-69 the share of trade in total bank credit declined from 51.7 per cent to 19.4 per cent and that of industrial sector went up from 32.0 per cent to 64.3 per cent. This fact makes it evident that during the period of the Second and Third Five Year Plans, Commercial Banks financed industrial
growth in the country and thus remained confined to the urban areas. Because of their profit motive, even their industrial finance was not in line with plan priorities and they were wholly ignoring the rural and weaker sections of the economy.\textsuperscript{34}

Commercial Banks, being urban based and profit oriented, preferred urban and port towns for their branches. This resulted in concentration of branches in some commercial centres to the total neglect of the rural centres.

Development Planning itself is of little relevance if the vast majority of the population constituting the urban and rural poor cannot participate in it or is denied the fruits of it.\textsuperscript{35}

In view of the lopsided banking development, the rural credit requirements and the spread of banking activities have received special emphasis at the hands of the Rural Banking Enquiry Committee and the Committee of Direction of the All India Rural Credit Survey. On the basis of the recommendations made by these committees, the Reserve Bank of India changed its branch licensing policy and gave a directive in 1955 to the newly established State Bank of India to open 400 branches in rural and semi-urban areas.\textsuperscript{36} Although the State Bank fulfilled this task assigned to it well before the stipulated period, other banks did not follow the suit. As a result, the rural and semi-urban centres remained neglected in regard to banking development. This resulted in an unbalanced regional infrastructure of commercial bank credit in the country. The Government, however, wanted to provide more credit to agriculture, small scale industries and other neglected sectors of the economy. The momentum was gained more prominently after the concept of Social control over commercial banks was propogated in 1967. With the setting up of National Credit Council in 1968, inter alia, to assess the demand for bank credit for various sectors of the economy and to determine priorities for grant of loans etc., it came to be felt increasingly that banks should become instruments of economic and social development.
The All India Rural Credit Review Committee appointed by the Reserve Bank in 1966 in order to reassess the developments that had taken place in the field of rural credit since 1954 also emphasised in its Report in July, 1969\textsuperscript{37} that, while re-organisation of cooperative credit should be pursued and the integrated scheme implemented vigorously, efforts should not be concentrated solely in the cooperative sector; that considering the magnitude of the problem of agricultural credit, the commercial banks, especially the nationalised banks should embark on wide and intensive efforts for provision of agricultural credit. Consequently, 14 major scheduled commercial banks were nationalised on 19th July, 1969. Six more commercial banks were nationalised on 1st April, 1980. The entry of commercial banks into rural finance has initiated new trends by encouraging the planning process at the grass root level and imparted a significant development orientation to deployment of funds in the rural areas.\textsuperscript{38} The Review Committee expected that banks would deal with a selected and limited number of cultivators mostly consisting of big farmers and also medium and small farmers who have moved on to commercial agriculture.\textsuperscript{39} For them, certain accommodation was to be made available in all the branches but in selected areas, banks were to make intensive efforts by posting suitable staff and trying out new ideas.\textsuperscript{40} However, the Review Committee warned against the danger of banks overcrowding in certain areas to the relative neglect of others while they felt that there was scope for banks to co-exist with cooperatives in all areas including the areas where the latter were strong. While the 'Study Group' on Organisational Frame Work for the Implementation of Social Objectives has thrown up ideas which were forerunners of rural banks and Regional Rural Banks, it has not recommended with details any new set-up.\textsuperscript{41} Within the existing set-up, the 'Study Group' recommended that the nationalised banks may take the place of cooperative system where it is weak or non-existent.\textsuperscript{42} The Study Group does recommend an all India machinery for continuously identifying the nature and extent of spatial, functional and territorial credit gaps in the economy within the overall strategy of economic development.\textsuperscript{43}
Soon after bank nationalisation in 1969, Reserve Bank of India announced a new branch licensing policy which classified the banks into two categories for the purpose of issuing licenses.

1) Category - I: Banks which had more than 60 per cent of their offices in rural and semi-urban centres and

2) Category - II: Other banks.

In the former case, the banks were permitted to open new branches in the ratio of one office for urban centre and one office for metropolitan/port towns for every two offices opened in rural or semi-urban centres, while in the case of other banks, the ratio was one office for urban centres and one office for metropolitan/port towns for every three offices opened in rural or semi-urban areas. Further, the Reserve Bank of India inculcated the concept of three year perspective plan to regulate the process of branch expansion in a phased manner and also help banks to coordinate their man power planning. The branch expansion policy was further revised in January, 1977 under which commercial banks were allowed to open one office each at metropolitan/port towns and at banked centres for every four offices opened at unbanked rural centres.44

There has been phenomenal increase in the number of commercial bank branches in India during the period 1969-1993. There has also been tremendous increase in branch network in rural areas during this period both in absolute numbers and in percentage terms of rural branches to total branches opened.

Table A-1 shows the resultant effect of Reserve Bank of India's policy of increasing the branch network in rural and semi-urban areas over the period 1969-1993. As a percentage, in 1969, the rural and semi-urban areas constituted 62.40 per cent of the total branches while the rest 37.60 per cent was accounted for by urban and metropolitan branches. But by 1979, the former's share went up to 69.90 per cent while the latter's share declined to 30.10 per cent. By June, 1989, the rural and
### TABLE A-1

**BRANCH EXPANSION OF COMMERCIAL BANKS AND POPULATION COVERAGE**

<table>
<thead>
<tr>
<th>Area</th>
<th>June, 1969 (Number)</th>
<th>June, 1979 (Number)</th>
<th>June, 1989 (Number)</th>
<th>March, 1993 (Number)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>1832 (22.20)</td>
<td>13064 (43.70)</td>
<td>29252 (51.38)</td>
<td>35301 (57.65)</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>3322 (40.20)</td>
<td>7821 (26.20)</td>
<td>13179 (23.12)</td>
<td>11417 (18.64)</td>
</tr>
<tr>
<td>Urban</td>
<td>1447 (17.50)</td>
<td>4695 (15.70)</td>
<td>3126 (14.25)</td>
<td></td>
</tr>
<tr>
<td>Metropolitan</td>
<td>1661 (20.10)</td>
<td>4294 (14.40)</td>
<td>6443 (11.31)</td>
<td>14517# (23.71)</td>
</tr>
<tr>
<td>Total</td>
<td>8262 (100.00)</td>
<td>29874 (100.00)</td>
<td>57000 (100.00)</td>
<td>61235 (100.00)</td>
</tr>
</tbody>
</table>

**Average population per Branch (in '000s)**

- June, 1969: 65
- June, 1979: 18
- June, 1989: 13
- March, 1993: 11

**Note:** Figures in parentheses indicate percentage to total.

# This figure includes branches in both urban and metropolitan areas.

**Source:**

semi-urban branches accounted for 74.44 per cent while urban and metropolitan branches accounted for just 25.56 per cent of total branches. And by March, 1993, the rural and semi-urban branches accounted for 76.29 per cent while urban and metropolitan branches accounted for a meagre 23.71 per cent. It is to be noted further that the total branches went up from 8262 in June, 1969 to 29874 in June, 1979; to 57000 by June, 1989 and further to 61235 by March, 1993. As a result, the average population served by a branch came down from 65000 in June, 1969 to 18000 in June, 1979, 13000 in June, 1989 and further to 11000 in March, 1993.

In the context of rural banking, the term 'rural' has been defined as rural centre or place which has a population of 10,000 or less and which is shown in the revenue records with a separate name of its own as per the Census figures. Thus the banking in India has been called upon to play an effective role particularly in the area of agriculture and rural development. In consonance with this policy, banks in India have also contributed quite significantly and a process of SILENT REVOLUTION has set in this area which may not have been realised as a conspicuous phenomenon.

After commercial banks started operating in the field of direct agricultural finance, it was recognised by them that one of the most important strategies to tackle the problems in this new field would be to follow the area approach.

The Study Group appointed by the National Credit Council in October, 1969 under the Chairmanship of Dr. D.R. Gadgil recommended the adoption of 'area approach' for providing banking facilities in unbanked districts. For this purpose, it suggested that banks should be assigned specific districts where they could act as pace setters in providing integrated banking facilities.

A Committee of Bankers appointed by the Reserve Bank of India soon after nationalisation of banks under the Chairmanship of Sri F.K.F. Nariman endorsed the above view and suggested that each bank should concentrate on certain districts for
assisting the process of regional development. The Reserve Bank of India accepted these recommendations and the 'Lead Bank Schemes' was launched in 1969 to give a concrete shape to the idea of the area approach for development of credit/banking facilities. Its two fold objectives are:

i) massive mobilisation of rural deposits; and 
ii) stepping up banks' lending to the weaker sections in India.49

Under the scheme, all the districts in the country were allotted by the Reserve Bank among the public sector banks and two private sector banks. The Lead Bank was expected to assume the 'lead' role in a systematic manner in a particular District. Other financial institutions and developmental agencies were expected to work in coordination with the designated Lead Bank. In a way, the Lead Bank was to work as a consortium leader for expansion of banking business and meet the credit requirements of the area - the district in question. The Lead Bank was expected to work out the credit gap in the district, prepare District Credit Plan and allocate the task of credit deployment amongst the financial institutions operating in the District. The Lead Bank was expected to act as a leader in matters relating to identification of prospective centres for opening of branches, mobilisation of deposits, identification of prospective productive activities and extension of adequate credit to help intensive utilisation of the economic potentialities of the concerned Districts.50 Another aspect of the scheme is the formulation of dynamic relationship between nationalised and non-nationalised banks, between commercial banks and cooperative credit institutions and between short and long term lending institutions. By 1990, three rounds of DCPs have been completed leading to phenomenal quantitative growth in bank credit. As a policy prescription the involvement of commercial banks in the promotion of rural development has reached a point of no return.51

The Reserve Bank of India launched another scheme of financing of Primary Agricultural Credit Societies by Commercial Banks in 1969 with the objective that
the Commercial Banks should meet the production and investment credit gaps in agriculture, finance small and marginal farmers by encouraging them to become members of Primary Agricultural Cooperative Societies, revitalise the working of the Primary Agricultural Cooperative Societies financed by them so that they become efficient business organisations at the village level and help in the process of speedy rehabilitation of weak DCCBs by taking over their affiliated societies for financing.  

The target approach to rural lending by commercial banks witnessed the emergence of the concept of priority sectors. The genesis of this concept can be traced back to the Report of the Study Group of the National Credit Council headed by Prof. D.R. Gadgil in 1968. The National Credit Council in its meeting held on July 24, 1968 emphasised that "Commercial banks should increase their involvement in the financing of two priority sectors namely agriculture and small scale industries as a matter of urgency.

The priority sectors came to be defined more elaborately in 1972 on the basis of the Report of Informal Study Group on Statistics Relating to Advances to the Priority Sectors constituted by the Reserve Bank of India in May, 1971. Besides agriculture and small scale industries, the advances made to road and water transport operators, retail traders, small businessmen, professionals and self employed persons and also for education were included. The share of these sectors in the aggregate advances of banks was raised to 33.3 per cent by March, 1979 and to 40.0 per cent by 1985. A Working Group under the Chairmanship of Dr. K.S. Krishnaswamy, Deputy Governor, Reserve Bank of India was set up by the Reserve Bank of India to look into the question of fixing sub-targets (within the enhanced overall target of 40.0 per cent for assistance to priority sectors) to the beneficiaries identified under the 20 Point Economic Programme. The Working Group under the Chairmanship of Mr. A. Ghosh, Deputy Governor, Reserve Bank of India, which was constituted by the Reserve Bank of India while recommending certain modifications in the definition of the priority sectors, recommended the target for direct agricultural advances to be
fixed at 14 per cent of the total credit. This was further revised in 1983 to 16 per cent to be achieved by March, 1987; in 1988 to 17 per cent to be achieved by March, 1989 and in 1989 to 18 per cent to be reached by March, 1990. Besides the overall targets, there are also other targets fixed by the Reserve Bank of India directing the banks to extend credit to small farmers, marginal farmers and agricultural labourers and also share croppers. In many cases, the results achieved by the banks vary by a narrow margin from the targets.

It must, however, be admitted that target setting was responsible to a large extent in compelling the banks to increase their exposure to the agricultural sector. But for the target stipulations and the periodical review of the banks' performance made in the Regional Consultative Committee, the State Level Bankers’ Committee and also the District Level Bankers’ Committee, the Banks would not have lent nearly 43 per cent of their advances to the priority sectors and about 17 per cent to the agricultural sector.

The Reserve Bank of India formulated and launched in 1969 the scheme of financing of Primary Agricultural Credit Societies by commercial banks. The main objectives underlying this scheme are that commercial banks should:

i) meet the production and investment credit gaps in agriculture;

ii) finance small and marginal farmers by encouraging them to become members of Primary Agricultural Cooperative Societies;

iii) revitalise the working of the Primary Agricultural Cooperative Societies financed so that they become efficient business organisations at the village level; and

iv) help in the process of speedy rehabilitation of weak District Cooperative Banks by taking over their affiliated societies for financing.

In January, 1971, Reserve Bank of India promoted Credit Guarantee Corporation of India Ltd., to administer guarantee schemes in respect of advances granted to priority sectors. Later, in 1978, this Credit Guarantee Corporation was merged
with Deposit Insurance Corporation and redesignated as Deposit Insurance and Credit Guarantee Corporation (DICGC). This Corporation administers the twin functions of insuring the deposits and providing guarantee for the advances granted by the credit institutions.

The Government of India introduced in 1972 the Differential Rate of Interest (DRI) Scheme. Under this scheme, selected low income group of persons (present income ceiling of Rs.6400 in rural areas and Rs.7200 in semi-urban and urban areas) are to be charged a concessional rate of interest of 4 per cent on the advances made. Banks have to lend atleast 1 per cent of their total advances as at the end of previous year under DRI scheme and atleast 40 per cent of such advances should go to Scheduled Caste and Scheduled Tribe beneficiaries. It was also stipulated that two-thirds of Differential Rate of Interest advance should be routed through semi-urban and rural branches. By June, 1987, banks had disbursed 0.98 per cent of their total advances under the DRI Scheme as against the target of 1 per cent.56

The Reserve Bank of India made another stipulation relating to the Credit Deposit Ratio to be attained in the rural branches. It was observed after the initial phase of the rural branch expansion from 1969 to 1976 that the rural branches were emerging as the mobilisers of rural deposits syphoning them for investment in the urban areas. This was apparently due to the time taken by the banks to evolve lendable schemes in the rural areas after establishing their branches. With a view to prevent the outward flow of the rural resources, it was stipulated by the Reserve Bank of India that the banks should attain a Credit Deposit Ratio of 60 per cent both in rural and semi-urban branches. This ratio became the indicator of the banks' involvement in a particular state and has been used freely both by State administration and banks for ensuring that the resources mobilised within the State are deployed within the State.

The Government started another new agency in 1973 called the Farmers' Service Society with a view to provide a national network of Integrated Credit Service for extensive modernisation of agriculture by utilising fully the talents, experience and
resources already available with cooperative and commercial banks. Each society is expected to cater to a minimum population of 10,000 and may cover a Community Development Block in full. There will be a union of such societies at the district level. The Lead Bank of the district has to provide the finance, guidance and supervision as well as the services of a Managing Director. Thus, these societies will be linked to the commercial banks.

The induction of commercial banks into the sphere of agricultural financing was not with a view to generate more competitive atmosphere in rural financing. It was essentially visualised that the role of commercial banks would be complementary to that of the cooperatives. A close scrutiny of their respective roles at a later stage brought out certain striking observations, much to the consternation of the advocates of complementarity in institutional financing, thereby exploding the myth of multi-agency approach. In the rat race to achieve the target requirements, very often the commercial banks and the cooperatives were apparently locked in a confronting posture which was not a comforting state of affairs at any rate.

The Reserve Bank of India’s Report on "Multi Agency Approach in Agricultural Finance" highlighted the need for streamlining nation’s institutional agricultural credit system to fill the growing gaps in agricultural credit. The Report expected the commercial banks to play a supplemental/supporting role to cooperatives in providing agricultural credit. The future branch expansion of commercial banks and Regional Rural Banks should be strictly regulated to prevent unnecessary proliferation of branches in the rural/semi-urban areas, where the network of cooperatives is fairly adequate. The Working Group suggested that, in areas where lending agencies are ineffective in meeting the credit gap due to managerial or financial weaknesses or where the cooperative network is inadequate, either Regional Rural Banks or Commercial Banks should be strengthened to meet the credit needs effectively.

The widening of the role of bank credit from 'Agricultural Development' to 'Rural Development' has made it imminent to have an apex institution to extend
support and give guidance to credit institutions in matters relating to the formulation and implementation of rural development programmes. The Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD)\textsuperscript{58} in its Report recommended the establishment of National Bank for Agriculture and Rural Development (NABARD). Accordingly, the National Bank was set up in July, 1982 by an Act of Parliament. Apart from providing refinance facility, the National Bank is expected to coordinate the functions of various financial institutions.

The multi-agency system brought in its wake double or multiple financing. To overcome this problem, the banks evolved at micro level the scheme of 'adoption of villages'. By mutual understanding amongst banks operating in the area it was usually agreed that the bank adopting the village will meet the entire credit needs of the village. Lead Bank Scheme was evolved as manifestation of 'area approach'. 'Area specific projects' were formulated and implemented. Despite all these, certain obnoxious characteristics including multiple financing, duplication of efforts in the same area leading to wastage of scarce resources, adoption of incongruent lending policies by different credit agencies etc., were found prevailing. A Seminar of top executives of banks and the Government of India was held on 9th and 10th January, 1988 and an important recommendation of the seminar was that with the large network of rural and semi-urban branches of commercial banks it was high time that specific areas to each of such bank branch is assigned as its 'service area' which should be mutually exclusive from the 'service area' of other branches of commercial banks.\textsuperscript{59}

The Service Area Approach Scheme was launched on 1st April, 1989 with the principal aim that every village in the country, however remote, would have access to banking facilities. Under the scheme, the service area of every rural of semi-urban branch will typically comprise 15 to 25 villages - proximity to the branch and contiguity of villages being the main criteria in allotting villages to a bank branch.
While the target setting for rural lending was perhaps the only expedient course available to the planners to accelerate the flow of credit to this sector and while targets have become mandatory over the years, the basis of target fixation has not gone beyond from where it originated. Besides, financial targets need not be sacrosanct in rural financing. In the look out for better securities and larger disbursals, an eligible credit-needy person will have a lesser bearing, simply because target achievement is a major preoccupation at present. It will not be surprising if the quality of credit service is relegated to the background under such circumstances.61

The programmes implemented by the banks for the poor are often characterised by lack of involvement of the poor themselves in conceiving, planning and evaluating them. The capacities and needs of the poor and the ways of meeting them are assumed by Banks or Government Departments and rigid schemes are formulated for implementation in wide areas having dissimilar conditions. The poor thus unwittingly become the 'objects of development' rather than being the 'subjects of development' exercising their will and capacities.62 Besides, the poor experience difficulties in borrowing from banks and complain of cumbersome procedures and long delays. They find the banks' schemes rigid and unsuited to their varied needs. They worry about the unsympathetic attitude and corrupt practices in banks in some cases.

There are many inadequacies within the banking system in so far as their ability to work with the poor is concerned which have greatly hampered them. They are oriented to business with non-poor sections of the community, whether urban or rural. Most of their personnel have urban background and their aspirations are directed to urban living, facilities and culture. The understanding of the problems faced by the poor and the ways and means of solving them and empathy for the poor are low. As a consequence, their commitment to the cause of serving the poor and motivation for the job are lukewarm.63
The Agriculture Finance Sub Committee appointed by the Reserve Bank of India, in its Report,\textsuperscript{64} indicated that the rural credit system to be really useful and effective, must take into account and pay attention to the entire gamut of credit requirements of agriculturists for three-fold purposes of consumption, production and other social purposes. The commercial banks lend mostly for productive purposes only and lend only a fraction of credit for consumption purposes. The poor have no alternative but to turn to the non-institutional sources of credit notably the money-lender.

Another vital strategic shift needed in Bank's business with the poor is from "Credit delivery" to "delivery of integrated services", with a substantial educational component. The programmes which have aimed predominantly at credit delivery have met with limited success in solving the poverty problem. This is on account of the need for inputs other than credit, in the absence of which credit by itself cannot further development. By providing motivation and incentive to save, by making available required physical inputs, technical advice/information service and other services like processing, marketing etc., and by providing production, investment and consumption credit, banks will be able to achieve greater success in meaningfully assisting the poor.

Though the Service Area Approach is well conceived, it is likely to create some practical problems like denial of rural financing to Agricultural Development Branches of State Bank of India located in urban areas, pressure on Branch Managers who are to decide to whom to lend in their particular area etc. Above all, how to mobilise adequate manpower to man the rural branches with new responsibilities on the Branch Managers is another problem. Given the officers' increasing reluctance to postings in rural areas, manning the rural and semi-urban branches in a way that can do justice to the Service Area concept in letter and spirit is going to be a tremendous task.\textsuperscript{65}
Rural lending still suffers from paucity of information. The rural poor should have access to correct information about programmes being implemented for them. The benefits of various programmes are at present appropriated by the relatively better off sections. Camps should be organised to educate the rural people about the various schemes, specially about the purpose of the scheme and its benefit to them. This will eliminate the mischief played by middlemen to cheat the rural poor.66

The Public Sector banks have also been suffering accumulated losses. In this context, profits and profitability in banking sector of India have a special significance. In the post-nationalisation era of social obligations, it was considered anathema to talk about profitability in public sector banks. These banks were considered as the institutional arms to mop up financial savings of the public for the fund starved Government and to dispense loans of questionable viability to enhance the socialistic ideals of the Government. Indeed, calling them "Commercial Banks" was a misnomer.67 However, in the context of present policy of liberalisation and deregulation, the Government is making efforts to set right the situation. The recommendations of Chakravarthy Committee, the reforms suggested by IMF and World Bank and the various recommendations of the Committee on Financial System headed by Sri M. Narasimham are being considered by the Government much more seriously.
NOTES AND REFERENCES


64. Reserve Bank of India, *op.cit.*, 1945, p.38.

