CHAPTER II
2.1 Need for Finance:

Like any other business activity, agriculture also needs financial support to attain optimum level of productivity. Indian agriculture has undoubtedly travelled a long way from its initial subsistence level of operation and it has yet to evolve a full-fledged commercial pattern of its operational spheres. In the process of transformation from subsistence level to commercialisation, a change from way of life to way of business, the output is not only monetised but also the inputs are also accordingly monetised. Indian agriculture through the process of commercialisation is undergoing a rapid stride from traditional to modern methods with the adoption of modern science and technology based farming necessitating thereby the demand for various types of inputs such as HYV seeds, fertilizers, insecticides, machineries and provisions of irrigation etc. As a result, the demand for credit is widening and deepening both in regard to magnitude and variety. Agriculture, though a dominant sector in the economy of India is backward in nature. The causes of such backwardness may be divided into two groups - credit and non-credit, though some of the non-credit may ultimately be due to credit factor.
The credit needs of farmers may arise to pay current expenses of cultivation, marketing of crops, to purchase cattle, implements, to acquire new lands, to make some improvements on lands, to pay old debts, to dwell houses, to pay cost of litigation, land revenue and also to meet certain expenses arising out of observance of some social and religious formalities. Credit needs, therefore, be for both productive and unproductive purposes. If the debts of the rural people are utilised for productive purposes, it will give a big boost to the agricultural sector. But if such debts are utilised for purposes other than for agriculture, the farmers will always remain in perpetual indebtedness and ultimately cripple them economically, socially and politically. The supply of land being fixed, there is no scope for increasing agricultural output unless intensive method of cultivation based on modern science and technology is applied. In the field of agriculture there is radical transformation from subsistence level to commercialisation, from a way of life to way of business, it assumes, therefore, increased production to create a marketable surplus. This has provided both a challenge and an opportunity to the financial institutions to meet the needs of rapidly changing and developing sector of agriculture.

Since the 60s, the new strategy on agriculture has been applied to attain self-reliance. "A major outcome of this effort is the identification of certain exotic and hybrid varieties of paddy, wheat, maize, Jowar and bazra which are responsive
to intensive application of fertiliser combined with the use of required quantity of pesticides and the adoption of other modern and scientific techniques of cultivation. The application of modern strategy in agriculture to boost up productivity and income necessitates higher doses of capital investment. Since improved technology is capital intensive and as the inputs are monetised, there is dramatic increase of cash needs both for short, medium and long duration. The costs for package of inputs would rise manifold, when improved techniques and methods are applied and since internal savings are scarce, finance from external sources at the right time and in adequate quantity become necessary. "It is therefore obvious that consequent upon these technological changes, the demand for production as well as investment in durable capital of development nature has also increased."

The percolation of credit from institutional sources makes it possible to increase production if it is placed at the disposal of farmers and as a consequence, there is scope on the part of hired man to become tenants and tenants to become owners. Cheap and organised sources of credit facilitate the organisation and operation of the farm on more profitable way to the greatest advantage of the farmers. The tempo of agricultural

1. Report of the All India Rural Credit Review Committee, p. 57
revolution cannot be kept in motion and sustained unless sufficient credit is available to the farmers on easy terms and conditions.

In India, small and marginal farmers constitute the majority, who lead a miserable way of life and even they are deprived of the basic amenities of life. Because of their extreme form of poverty, they have no surplus at all to invest on costly inputs required by modern agriculture to derive the maximum benefit and ultimately they are forced to borrow from the Shylock-Mahajan for meeting both consumption and production credit. Supply of credit in adequate amount at appropriate time is considered to be one of the vital pre-requisite for sustaining and fostering technological changes in agriculture and this will pave the way for increased production, productivity and income and enable them to save from the clutches of the money-lenders. Moreover, social justice also necessitates adequate attention to credit needs of this section of the farmers. The All India Rural Credit Review Committee has also concluded "it is therefore, all the more necessary that less affluent cultivators should be enabled through states and institutions' support to improve their production potential and levels of income by adopting improved agricultural practices." Therefore, small and marginal farmers should be selectively helped with

adequate and timely credit at reasonable cost from institutional sources.

Agricultural credit in India has been marked by predominance of non-institutional credit such as private moneylenders, traders, relatives and similar individual lenders. Credit from private sources are on unfavourable terms and therefore, the farmers are not able to take full use of the loan for agricultural production. The moneylenders charge exorbitant rate of interest, which the farmers cannot pay and so debt-burden increases and the farmers virtually work for the moneylenders. In other words, the income derived from agriculture is actually utilised for the payment of interest, farmers therefore, are hesitant to show their eagerness to adopt improved technology and methods for bulk of the benefits would go to the moneylenders in the form of interest, leaving them with no surplus.

The non-institutional sources, according to the All India Rural Credit Survey Committee contributed about 93% of the total amount borrowed by the cultivators. The estimated percentage for the different agencies are shown as follows (Table 2.1):

5. All India Rural Credit Survey, Report of the Committee of Direction, vol. II, p. 167
Table 2.1

SOURCES OF RURAL FINANCE

<table>
<thead>
<tr>
<th>Credit Agency</th>
<th>Proportion of borrowings from each agency to the total borrowings of cultivators (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Government</td>
<td>3.3</td>
</tr>
<tr>
<td>2. Co-operatives</td>
<td>3.1</td>
</tr>
<tr>
<td>3. Relatives</td>
<td>14.2</td>
</tr>
<tr>
<td>4. Landlords</td>
<td>1.5</td>
</tr>
<tr>
<td>5. Agricultural moneylenders</td>
<td>24.9</td>
</tr>
<tr>
<td>6. Professional moneylenders</td>
<td>44.8</td>
</tr>
<tr>
<td>7. Traders and Commission Agents</td>
<td>5.5</td>
</tr>
<tr>
<td>8. Commercial banks</td>
<td>0.9</td>
</tr>
<tr>
<td>9. Others</td>
<td>1.8</td>
</tr>
<tr>
<td>10. Total</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: All India Rural Credit Survey, Report of the Committee of Direction, vol. II, p. 167

It is observed here that non-institutional sources provided about 93% of the total credit. Private moneylenders both agricultural and professional contributed about 70% of the total finance predominated the rural economy particularly the agricultural sector. The rates of interest charged by them often varied between 25% and 75% depending upon the nature of security offered and the extent of risk involved in such
investment. Such exorbitant rate of interest is due to monopolistic or semi-monopolistic position enjoyed by the moneylenders in rural areas. "While it is true that the moneylender is the most important constituent of the agricultural credit machinery of the country, it is not possible to justify many of his practices and the charges he makes for his services. Very often these charges are out of all proportion to the risk involved in the business and constitute an exploitation of the helplessness, ignorance and the necessity of the borrower. Nor is the agricultural economy of the country in a position to bear the strain of his extortion. The credit dispensed by him instead of contributing agricultural prosperity of the country serves as serious drag on it." Institutional sources of finance ameliorate the farmers from exploitation, and this will give a boosting effect to production and income.

Besides, farmers also used money to meet their consumption requirements. The cultivators dispose bulk of their products soon after harvestment and then find it necessary to borrow as they realise cash from sale of crops only at certain period of the year, whereas their expenditure is more evenly distributed all over the year. Therefore, to satisfy both consumption and investment needs, they borrow, but on unfavourable terms and ultimately surrender their plots of land to the moneylenders. Therefore, they need money on easy term from

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some other sources to satisfy both consumption and investment needs. Institutional agencies, in addition to the provision of farm finance can extend farm guidance on matters pertaining to selection of seeds, manures, production technique, storing marketing of crops etc. through their extension services. Institutional agencies have resources at their command, manpower and expertise at their disposal which may enable them to offer right dose of finance at right time and also proper guidance on farming matters. While appreciating the importance of institutional finance to agriculture, the Rural Credit Review Committee said "as the agricultural sector of the economy becomes an era of dynamic growth and viable business, it assumes greater relevance for the banking system which has to mobilise the savings of the community for financing economic activity." 7 The Rural Credit Review Committee in its report expressed the view that financial assistance to the farm sector by the commercial banks should be linked up with (a) Production credit, (b) Investment credit, (c) Credit for infra-structure, (d) Distribution credit, (e) Credit for activities jointly undertaken with agriculture, (f) Credit to Co-operatives engaged in agricultural activities. 8

7. Report of the All India Rural Credit Review Committee, p. 24
8. Report of the All India Rural Credit Review Committee (ibid), p. 591
2.2 Types of Credit needed:

Credit needs of the farmers may be classified periodwise, purposewise, securitywise and creditorwise. The periodwise classification is a general classification of which the other three, viz., purpose, security and creditor may be regarded as sub-division within each group.⁹

However, based on purpose and duration of borrowing, agricultural credit may be divided into following three heads:

(A) Short term credit:

Short term credit may be borrowed for a period not exceeding 15 months to meet current agricultural expenses of cultivation such as the purchase of inputs like seeds, fertilizer, pesticides and to make wage payment for hired labours. Such advances are expected to be repaid after the harvestment of crops.

(B) Medium term credit:

Comparatively bigger sums of money may be borrowed for longer duration but not exceeding a period of 5 years for purchasing cattle, pump sets and implements. These loans are to be repaid by half-yearly or annual instalments which usually coincide with the harvesting of crops.

⁹. All India Rural Credit, Report of the Committee of Direction, vol. II, p. 153
(C) Long term credit:

Larger sums of money may be necessary to the farmers to acquire new lands or to improve land by irrigation, drainage system, to purchase costly machinery like power tillers, tractors, harvesters etc. Such loans are generally granted for a period exceeding five years and even up to 20 years against mortgage of immovable property.

However, banks provide crops loans on the basis scales of finance fixed per acre and per crop. Such crops loans consist of both cash and kind components. While providing crop loans commercial banks insist on the farmers to lift first the kind component in order to make them eligible for procuring cash component later on.

Provision of adequate and timely institutional finance is urgently necessary in the context of present day agriculture in India. Short, medium and long term credits are necessary by the farmers at different stages of production. But under the changed conditions, pressing need is the provision of long and medium term credit as the same is not readily available to the agriculturists in most of the underdeveloped countries including India.10

10. Ghosal, Dr. S.N., op.cit., p. 15
Finance obtained by farmers may again be categorised as direct and indirect. Direct advances are made to farmers for acquiring agricultural inputs and for meeting other auxiliary expenses on agricultural operation right from sowing to harvesting, processing, storage, transportation and marketing of agricultural output. In addition to this, the farmers obtain indirect finance through agencies and individuals. The indirect finance includes advances for the distribution of agricultural inputs. Commercial banks provide indirect finance to farmers through co-operatives in the form of short, medium and long term loans. The commercial banks release their funds to the farmers indirectly through the Primary Co-operative Society where the base level as well as higher level co-operative structure is weak and is unable to provide the required degree of credit support to base level co-operatives. In these areas the commercial banks have been required to finance primary level co-operative societies. Commercial banks also enroute their funds through the Farmers Service Society (F.S.S.), Large sized Agricultural Multipurpose Societies, Co-operative Marketing Societies, Marginal Farmers and Agricultural Labourers Development Agencies established with the responsibility of identification of borrowers and areas of assistance. The credit extended by banks through the Small Farmers Development Agency and Marginal Farmers and Agricultural Labourers Development Agencies were later merged into Small Farmers Development Agency (SFDA). But with the launching of IRDP, the SFDAs have been abolished as the IRDP is made
to take care of SFDA's responsibility. The emergence of National Bank for Agriculture and Rural Development in 1982 has provided far reaching effect in the provision of schematic finance through the co-operatives, Regional Rural Banks and commercial banks for the benefit of the farming community.

2.3 Special Features of Agricultural Finance:

As revealed from the Report of the All India Rural Credit Survey Committee, private sources contributed about 93% of the total rural credit of which the moneylenders alone contributed about 70% of the total supply of credit in 1951. Institutional agencies (including Government) together supplied only 7% of finance (Table 2.1). The basic problem of farm finance in India is exploitation by moneylenders by way of exorbitant rate of interest, unfavourable terms and conditions and indebtedness which passes from generation to generation and ultimately reducing the farmers to the status of serfs and semi-serfs. Indian farmers being poor and ignorant easily fall into the clutches of the Mahajan and thereby sink deeper and deeper into debts, indebtedness rises which brings miseries and catastrophe, but never stimulates productivity and income earning capacity. If borrowed from non-institutional sources, ultimately the farmers are forced to surrender their plots of land to the Shylock Mahajan and in this process most of the agricultural holdings become uneconomic, the farmers become landless agricultural labourers. But it cannot be denied
that borrowings from private sources have some merits compared to institutional sources of credit in the sense that in case of the former, the personal knowledge which the Mahajans have relating to credit worthiness or other informations of the borrower help in dispensing with many of the formalities which an ordinary agency might be compelled to go through in advancing a loan. These formalities are time consuming and costly too. But the moneylenders because of their strong socio-economic status in the society and also due to monopolistic positions are able to exert unhealthy practices in financial transaction.

Inadequate supply of credit from institutional sources has become a constraint in the use of inputs and investment in agriculture. "Inadequate supervision over the end use of credit, slackness in follow up action in recovery and lack of effective co-ordination between lending activities of institutional agencies on the one hand and developmental programmes of the State Government, input supply and extension services on the other hand have seriously constrained adequate flow of credit to agriculture."11

Again, consumption loan forms a large part of the debt of the rural people and loan for unproductive purposes for meeting medical, education and other purposes form a substantial portion of the debts. Consumption loan is usually taken by

11. Report of the Committee on Agricultural productivity in Eastern India, p. 74 (RBI), 1984
small and marginal farmers and such fund is provided by village Mahajans and rich farmers and they exploit their necessity by paying low for the produce which is offered to them for the repayment of principal and interest.\textsuperscript{12}

Security oriented lending by commercial banks, develops some peculiar problems in farm financing. Merchants, manufacturers can borrow from commercial banks against stock of goods, inventory, machinery etc. which can be easily converted into cash in case of default, but lending to farmers against land as security cannot be easily converted into cash, besides complications may arise due to title and possession over the land. Loans against standing or future crops may bring uncertainty if there is crop failure due to flood or drought. Similarly finance against cattle involves risk if deaths occur due to epidemic etc.

Inspite of technological break-through, Indian agriculture has still remained 'a gamble in the monsoon' - two good crops followed by two bad crops and an indifferent one. The commercial banks are, therefore, not enthused to release their funds for agriculture as the risk involved in such investment is very high. The complex nature of Indian agriculture emerging from small and fragmented land, number of small and marginal farmers

\textsuperscript{12} Report of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development, pp. 17-18 (RBI), 1981
and agricultural labourers spread over a wide area make the supervision and follow up action very difficult. The characteristic features of the small farmers are use of high proportion of land for growing food crops for subsistence, inadequate marketable surplus, inability to take risk, preponderance of labour among output. The problem of small and marginal farmers need an integrated approach to their requirements combined with supervised credit. Unless the institutions which are connected with the rural producers is adequately equipped to provide integrated services combined with credit, the complex answer to their problems is likely to emerge.

The basic needs of Indian farmers is cheap and timely credit. The cooperatives which were expected to take the responsibility at the grass root level could not make much headway because of some inherent weaknesses in it. As a consequence, a vacuum is created and so the farmers step into the parlour of the Mahajan. Commercial banks because of their urban origin and security consciousness and unsuitable nature of methods and procedures for financing the farm sector could not make much progress, although this sector contributed much to the national economy, although only in recent times the contributions of commercial banks to the farm sector have shown an upward trend.

13. ibid., p. 16
Large amount of overdues due to non-refund of loans by farmers is a peculiar feature of farm finance in India. Too much of overdues is likely to threaten financial soundness and also liquidity and profitability of the lending institution on the one hand and encounters in recycling of funds on the other. The large amount of overdues in agricultural sector may be due to defective appraisal of loan applications and inadequate monitoring of credit utilisation, natural calamity, wilful defaults, misutilisation of funds and weaknesses in recovery procedures, which need immediate pragmatic remedial measures, otherwise the purpose of agrarian revolution will be frustrated.

2.4 Disbursement of Loans and Supervision of Credit:

However, institutional sources of finance to be effective should satisfy certain criterions. The success of credit institutions and prosperity of the peasantry depend primarily on productive utilisation of loan. Proper end use of loan is more important than the provision of adequate credit itself. If credit is used other than the purpose for which it is borrowed, it may not only cause low production and bind the farmers to indebtedness but also leads to vicious circle of poverty. It is also necessary that credit is made available in right quantity at right time and repayment of such credit should always coincide with the season of cultivation and

recovery should be at a time when marketing is at the optimum level. The mode of disbursement should always be in kind instead of cash as far as practicable. Payment should be made to the supplier of inputs against borrowers acknowledgement on receipt of materials. It is necessary on the part of the financing bank to put a check on the likely malpractice by the supplier in regard to the quantity, quality and also price of the inputs supplied. Loans disbursed to the farm sector should be linked up with credit-worthiness of person and purpose, viability of the scheme, and prospect of income earning instead of security consciousness on the part of the credit delivery system. Security for loan should be subordinated to the anticipated repaying capacity generated by the productive use of credit itself. It is essential that agricultural loan must encourage modernisation and diversification of farming to raise productivity and income and there should be some monitorying authority to oversee that the loans are used for productive purposes only and also regular demand for repayment of such loans should be insisted on for early recovery. A close interaction between the banker and the farmer can have a far reaching effect on the proper end use of fund and also development of agriculture. Bank officials should develop greater contacts with the farmers through regular field visits to ascertain the progress of cultivation, verification of security

offered for the loans and of implements purchased with the use of bank finance and to ascertain whether finance already provided has been properly utilised and also to assess the quantum of finance necessary for further agricultural operation.

The methods that should be followed by the credit delivery system are "quick and simpler method of identification of the target groups, simplification of procedures and terms, project based lending in place of security based lending, creation of inputs and services and other similar methods which would enable the credit institutions to properly deliver credit to the largest groups"\(^{18}\) for the greatest benefit of the agrarian sector.

The objective of agricultural credit policy, therefore, should be to provide credit to the farm sector through institutional sources in adequate amounts at reasonable rates of interest and at proper time and with repayment terms determined in relation to harvesting of crops. Further, when technological innovations become available to the farmers, if their adoption requires larger cash outlays, the credit system should meet the higher agricultural credit demand. Without adequate credit support, transformation of traditional agriculture into dynamic one becomes impossible. Therefore, what is technically possible,

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18. Report of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development, pp. 17-18
economically viable should be made financially feasible, otherwise, the complex problem of rural finance in the sphere of agriculture will ever remain in India which may not only upset the process of orderly and peaceful transition of the rural economy, but even frustrate the rational efforts to step up agricultural production.