CHAPTER- II

AGRICULTURAL INVESTMENT AND INSTITUTIONAL FINANCE:
THE DEMAND AND THE SUPPLY SIDES

In traditional agriculture, implements and animals required in the farming process were mainly domestically produced or acquired in exchange from fellow farmers, local traders, etc. In such a system, farm investment was mainly related to the time consumed and materials required for making implements and rearing draught animals or in the form of commodities and services used in exchange for acquiring the farming inputs. So, finance was not involved in a major way in this system. But with the gradual progress of agriculture to a modern system where farming operations are performed with sophisticated machinery run with commercial energy (e.g. electricity or fuel like diesel, etc) and where farming involves the use of such bio-chemical inputs as well-bred seeds, fertilizers, pesticides, etc, the amount of finance involved is very large.

2.1. THE DEMAND SIDE

2.1.1. Conceptual Issues
The 'fixed capital' of agriculture includes, plant and machinery and renovation or improvement of irrigation and drainage structures like tanks, dug and tube-wells, construction of farm structures, land improvement, etc. The 'working capital' of agriculture includes, requisites
such as seeds, manure, pesticides, expenditure on fuel used to run farm machinery, etc, together with the goods which the farmer and his family consume during the process of production and marketing, as well as the things obtained by the wages paid to hired workers and to those who handle the farmers products before they are sold. This type of capital used in the farming process can also be termed as a category consisting of flow inputs which are used up in a single round of cultivation and the returns on investment on them are earned only once as soon as the harvest is sold in the market. The first type of capital i.e. 'fixed capital' on the other hand consists of such items which can be utilized over and over in successive rounds of cultivation. The returns on investment on such assets accrue to the farmers not in a lump sum but a series of sums spread over a time span (Karthikeyan, 1990).

2.1.2. Credit Needs of a Farm-household

The demand for capital is translated into a demand for credit. Farmers demand credit for the following purposes –

(a) Consumption credit, which involves personal, domestic and non-farm expenses, i.e., expenditure on food, clothing, religious and social functions, etc or in other words expenditure on necessaries and on other activities not related to farm expenses as such.

(b) Production credit, which involves farm expenses of recurring nature and related to agricultural operations i.e., expenses on
seeds, fertilizers, pesticides, fuel for running farm machinery, manual and animal labour hiring-in charges, etc.

(c) Investment credit, which involves expenses incurred on permanent additions, improvement of farm assets i.e., purchase of farm equipment like power tillers, pump-sets, tractors, etc, and on land improvement, bunding, fencing, construction and improvement of storage structures and cattle sheds.

Farmers, specially in developing economies like India, are not in a position to buy outright the whole of capital represented by land and improvements on it. Some part of the finance required in the production process must be obtained by borrowing. So, investment credit is required in just the same way as in other branches of industry. A similar demand also arises for production credit.

The above observations deal with the reasons behind the demand for agricultural credit by the farm sector. The essential sources through which this demand is met i.e. the supply mechanism, is of crucial importance for the sustenance of agriculture in India.

2.2. THE SUPPLY SIDE
2.2.1. History of Agricultural Credit Supply Mechanism
Traditionally, credit to agriculture was supplied by such informal sources as moneylenders, merchants, landlords, etc. These non-institutional sources are still prevalent to a certain extent in the rural areas.

On the institutional side, the Commercial banks constitute quantitatively the most important para-banking institutions in India. They invest and lend not only what they are enabled to mobilize from the accumulated savings of the public but much more than that owing to their manufacture of chequing account money which distinguishes them from other banking and financial institutions. Despite the fact that the commercial banks have been functioning for the last two centuries, the growth consciousness among them is a fairly recent happening.

2.2.2 Institutional Finance before 1970
Institutional financing of agriculture first made its inroads into the farm sector in India in 1904 with the introduction of the co-operative system. But this system remained quite ineffective till the recommendations were made by the 'All India rural credit survey committee' in 1954 to institutionalize farm credit through co-operatives and banking institutions. Emphasis was also given on the simultaneous development of cooperative marketing, processing, storage, etc. The Government of India had requested the Reserve Bank of India (RBI) to coordinate and oversee the implementation of the scheme and provide adequate financial support to the co-operatives. There are two wings of the co-operative credit structure in India, one wing which provides short-term and medium term loans and the other which provides long term loans. The former has a three-tier
structure with the state co-operative bank at the apex level, central co-operative bank at the district level and primary agricultural credit societies at the village level. The latter includes the state co-operative land development banks and primary co-operative land development banks. The Co-operative land development banks play a significant role in the provision of investment credit to agriculture. The origin of these banks goes back to 1920 when the first bank was established in the small town of 'Jhang' in Punjab. Four years later, a second such land mortgage bank (as they were formerly known) was set up in 'Nagaon' in Assam (which was then in the erstwhile province of Bengal). After Independence, the growth of these banks has been rapid. The main objective of these banks is to provide term finance to meet the investment needs of the rural sector, mainly agriculture (Choubey, 1993).

Before 1970, it was exclusively the co-operatives which were a major source of institutional credit in the rural areas. The Government of India, through various attempts like procedural and administrative reforms and provision of credit facilities at concessional terms from the Reserve Bank of India, has tried to nurture the co-operative societies. But in spite of all these measures undertaken, the co-operative system could account for only 3.1 per cent of the total borrowings of cultivators. The 'All India Rural Credit Survey' was undertaken by a committee headed by Gorwala and appointed by the RBI in 1951-52. The survey revealed that the shares of institutional and non-institutional sources of rural credit were 7.3% and 92.7% respectively. Among its various recommendations, it suggested that the amalgamation of the Imperial Bank of India and certain state
associated banks be done to form the State Bank of India to provide vast remittance facilities for co-operative and other banks and to promote coordination between the rural and co-operative credit and the banking system (Reddy, 1989).

In November 1958, the National Development Council recommended that the responsibility and the initiative for social and economic development at the village level should be placed fully on the co-operatives. The V. L. Mehta Committee (1959) also favored revitalization of a large number of credit societies to expand rural credit. The committee felt that the government could contribute to the share capital ranging from Rs.1000/- to Rs.10,000/- on a matching basis and its contribution to "the special bad debt reserve" to weak societies. The committee recommended for the provision of funds even to tenant cultivators. It suggested that a large portion of the loan should be in kind to avoid misapplication of loans.

The Government of India appointed the Patel Committee in July 1961 to look into the organizational, procedural and administrative difficulties associated with routing of 'taccavi' loans through co-operatives. In 1963, this committee came out with the proposition that all loans for normal production should be arranged through the co-operative institutional agency and the government would have to provide finance directly to the farmers only in certain cases of high financial risks. The committee desired that effective steps should be taken to rationalize the central banking structure so that there would be one central bank for each district. It also recommended that steps would be taken to create an agency of land
mortgage banks at a level below the district level wherever the primary land mortgage banks functioned at district levels only.

The Mirdha Committee constituted by the Government in 1964 felt that the co-operative movement is best suited to protect the poor and needy from the "exploitation of the rich and it is an instrument for promoting social justice".

The All India Rural Credit Review Committee which submitted its report in 1969 came up with various suggestions related to agricultural credit like-

(a) the introduction of crop loan system in areas where it was not in existence,

(b) Simplification of lending procedures to improve the level of production and the recovery rate,

(c) establishment of small farmers development agency (SFDA) to identify the major problems and to help meet the needs of small and marginal farmers etc.

The Santhanam Committee which also submitted its report in 1969 had come up with the recommendation that finance provided by the banks to cultivators should also include a reasonable amount for meeting their consumption expenses. In the same year, after a review of the working of the co-operatives, the government of India felt that for a faster growth in
agriculture, a multi-agency approach was needed. As such in 1969, 14 leading commercial banks were nationalized with the purpose of advancing finance to the agricultural sector. This process started with the main objectives of achieving a wider spread of bank credit preventing its misuse, directing a large flow of credit to priority sectors, paying special attention to growth potential and developmental needs of local areas, endeavoring to meet the productive efforts of diverse kinds irrespective of size and social status of the borrowers, etc (Sanjeevaiah, 1998).

2.2.3. Institutional Credit after 1970
In 1971, the National Commission on Agriculture suggested the setting up of Farmers Service Societies (FSS) to provide credit, technical guidance and other support to small farmers. These societies would be financed either by commercial banks or co-operative banks. This suggestion was accepted and was put into operation in 1973-74. In 1971, itself, a special study group under the chairmanship of Bawa, recommended the organization of ‘Large sized Adivasi Multi-purpose Co-operative Societies' in the tribal areas, for providing credit, technical know-how and marketing facilities for agricultural products (Sanjeevaiah, 1998).

The Hazari Committee (1975) on integration of co-operative credit institutions proposed the integration of short and medium and long term wings of co-operative credit institutions for achieving better results but no decision could be taken on this. In 1976, the Kamat working group studied the problems of overlapping and duplication of institutional credit as a result of the multi-agency approach, recommended that there should be
geographical rather than functional demarcation for each credit agency. In spite of the rapid expansion programme undertaken by the commercial banks, a large portion of the rural economy still remained beyond the reach of the organized commercial banks. So, in order to fill up this gap the government of India felt the necessity to create another agency to cater to the needs of the agricultural sector in India. So on the basis of the recommendations of the working group under the chairmanship of Narasimham (1975), a new type of institution capable of understanding the local needs and problems, in mobilizing deposits, etc. i.e. the Regional Rural Banks (RRBs) were set up under the Regional Rural Bank's act in 1976. Again in 1980, six other commercial banks were nationalized, thus raising their number to twenty.

The Regional rural banks were first set up in 1976 with the main objective of developing the rural economy by providing credit and other facilities for agriculture and other productive activities of all kinds in rural areas. The main emphasis is supposed to be on the provision of such facilities to small and marginal farmers, agricultural labourers, rural artisans and other small entrepreneurs working in rural areas. The special features of these banks are-

i) The area of operation of each rural bank has been limited to a specified region comprising one or more districts in any state.

ii) The lending rates of these banks cannot be higher than the prevailing lending rates of co-operative credit societies in any particular state.
iii) The salary structure of the employees of these banks has been fixed in consonance with the salary structure of the employees of the state government and local authorities of comparable level and status in the banks area of operation.

The paid-up capital of each rural bank is Rs.25 lakhs, 50% of which has been contributed by the central government, 15% by the state government concerned and 35% by the sponsoring public sector commercial banks, which are also responsible for the actual setting up of RRBs. Hence these banks have a bigger stake in so far as the rural economy is concerned and as such have been strongly focused in this study.

In 1979, the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development headed by B. Sivaraman (RBI, 1981) called for the setting up of the National bank for Agriculture and Rural Development under the control of the Reserve Bank of India (RBI) to decentralize its functions. In its final report in 1981, it also recommended that terms and procedures of credit should be made simpler, lending should be project based, credit to weaker sections should be quickly facilitated, etc. As a result of the recommendations of this committee, the National Bank for Agriculture and Rural Development (NABARD) came into existence on July, 1982 as an apex bank for rural credit. The main aim of this bank is to pay undivided attention and forceful direction to rural credit. Departments like the Agricultural credit department and Rural planning and credit cell of the RBI have been merged into the NABARD. It provides short and medium term refinance assistance to state co-operative
banks, regional rural banks and any approved financial institution and also to state land development banks.

2.2.4. Reform Packages in Institutional Credit after 1990

In 1991, the Narasimham Committee report (RBI, 1991) suggested that the system of directed credit programmes should be gradually phased out. It observed that the growth of agriculture and small industry in India had reached a point where the legitimate productive requirements of these sectors could be met by banks on the basis of their commercial judgment. Moreover, it felt that credit for agriculture and small industry should be on the basis of supervised credit and on a proper techno-economic appraisal of proposals and without any interference, either political, administrative or judicial in credit decisions.

The R.V. Gupta committee was set up in December 1997 (RBI, 1997) to suggest measures for improving the delivery systems and simplification of procedures for agricultural credit. The RBI issued directives to the banks to immediately implement the valuable recommendations which the committee has suggested are as follows-

a) Delegation of adequate powers to the branch managers to enable disposal of 90% of loan applications at the branch level including modification of the powers at the branch level.

b) Ensuring that pre-sanction appraisal of the borrower focuses on income stream of the borrower, his credibility, his capability for taking up the activities proposed, integrity and technical viability of the proposal.
c) Introducing annual composite cash credit limits to all agricultural borrowing families.

d) Designing a fully liquid savings module with an appropriate return and in-build the same in the loan product which will take care of farmer’s interests in the event of adverse price fluctuations or natural calamities.

e) Disbursing of all loans for agricultural purposes in cash which will facilitate dealer choice to borrowers and foster an environment of trust.

f) Dispensing with the production of “no-dues certificates” from banks/institutions by borrowers as a compulsory requirement.

g) Evolving an appropriate mechanism to monitor recovery performance in respect of agricultural loans, particularly in regard to old and sticky loans.

h) Ensuring that the value of security taken is commensurate with the size of loan and desist from asking additional collateral by way of guarantors where the land mortgaged is considered adequate.

i) Using discretion on matters relating to margin/security requirements for agricultural loans above Rs.10,000/-.

j) Furnishing the borrowers with a clear statement of the credit availed of by him separately indicating various fees and charges for introducing an element of transparency.

k) Ensuring that the officials of the internal inspection team visit villages covered by each branch and meet farmers to discuss their problems during the course of their inspections so as to obtain a feedback on the quality of interaction which the branch officials have at the ground level.
l) Ensuring that the chairman and managing directors of banks pay surprise visits to their rural branches during their tours to states which will send appropriate signals to the field level staff.

m) Considering giving weightage in the performance appraisal system to increase in the outreach measured by the number of new clients, incremental increase in flow of credit and loan recoveries.

n) Considering evolving a package of incentives to motivate the staff.

o) Designing specific loan products to the borrowers in non-farm sector to enable them to pursue a number of non-agricultural activities alongside their agricultural activities for supplementing their income.

p) Ensuring operationalization of a model set of documents prescribed by the working group on non-governmental organizations and self-help groups relating to agreements among members, loan formats, application forms, etc.

q) Ensuring that farmers are given the right advice regarding the cultivation of crops, inputs to be used.

r) Linking up the activities of rural branches with farmers clubs established with the initiative of the National Bank for Agriculture and Rural development (NABARD) with a view to facilitating technology transfer regarding agricultural operations, wherever possible.

s) Undertake a review of the banks' hi-tech agricultural branches with a view to identifying the branches which are not working well due to inadequate expertise and lack of demand, also ensuring that these hi-tech branches are used to disseminate information relating to agricultural operations specifically for providing technical information regarding cultivation of high value crops.
This committee has a large reform package in its fold with regard to agricultural credit in general. It remains to be seen how much can be percolated and implemented at the grass-root level for things to take shape in the desired manner.

The Expert Committee on Rural Credit (NABARD, 2000) was constituted to take a close look at the rural financial institutions and the policy impact on the rural credit delivery system. In its report submitted in August, 2000, it reviewed the totality of rural credit institutions and recommended strategies and approaches to meet the challenges of the future. Some recommendations made in the report are as follows:

- Target oriented subsidy driven programmes can have only a limited impact on asset creation and income generation on a sustainable basis. Successful experiences of forming self help groups of the poorest, especially rural women, encouraging them to save and providing micro finance has proved that the poor are bankable even without subsidies. This approach, with support in capacity building is the best.

- The prevailing situation in land holdings and leasing should be recognized and appropriate procedures designed to incorporate these rights in collaterals.

- With the decline in public capital formation and growing importance of private investment, financial institutions must prepare for a more proactive role, shedding excessive caution and exploring alternative methods of providing insurance.
• Commercial banks were made to expand their rural operations substantially after nationalization. Because they have to service vast numbers of small accounts—both deposit and borrowing, the process becomes costly and cumbersome. They prefer instead the safer (and remunerative) alternative of meeting targeted levels of lending to agriculture, investing the shortfall from the target in Rural Infrastructure Development Fund (RIDF). They also face problems of some non-viable branches, unmotivated or unwilling staff posted to rural branches with inadequate training and sensitization, and some procedural problems, which place them at a disadvantage as compared to co-operatives. But commercial banks cannot be allowed to withdraw from rural credit. They should offer value added services, e.g. insurance through their rural branches either on their own or by tying up with others to improve viability of rural branches.

• There is an urgent need for improving the legal environment both to increase the disbursal of rural credit and achieve better recovery. For this, the bank should take a more flexible approach in the disbursal of rural credit and state Governments should support their efforts by:
  a) improving and updating of land records
  b) waiving stamp duty and registration fee on loan documents upto a certain limit
  c) notifying block headquarters and all places where banks are located as eligible for creation of equitable mortgages
d) authorizing Tribal Development Corporations to bid in auctions of tribal lands to ensure that the land is properly valued and remains within the community.

- To improve recoveries, the central and state Governments should desist from giving blanket remissions in loans and/or interest and the grant of relief to borrowers by conversion of short term loans into medium term loans in the event of natural calamities should be left to the assessment of situation by the banks in a given location.

The different stages in the development of the credit supply mechanism of the country from their emergence to the present period gives an idea of the various institutions supplying credit and the policy changes which have been made overtime to meet credit needs of the different sectors of the economy. In the present study nationalized commercial banks, regional rural banks and co-operative land development banks with more emphasis on the RRBs (which mainly hold the key to accelerating development at the grass roots) operating in the rural sector will be studied to see whether in spite of reform packages taken up from time to time, financial institutions have been able to meet the credit requirements of the rural farmer in Assam and more specifically to understand the dynamics of farm investment vis-a-vis institutional finance for the same.

A review of studies taken up in this area have been discussed in the following chapter.
References


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