An Analysis of Institutional Financing and Agricultural Credit Policy in India*

Devaraja T.S.
Post Graduate Department of Commerce
University of Mysore
Hassan, India

Tel: Mobile: +91 98807 61877
: +91 – 8172 65100
Fax: +91-8172 240674
Web: http://devaraja.me
Email: mail@devaraja.me

* The work described in this working paper was substantially supported by a grant from the University Grants Commission of India

An Analysis of Institutional Financing and Agricultural Credit Policy in India*

This version: May 2011

Abstract

This working paper attempts to analyse the issues in institutional credit in India. The analysis reveals that the credit delivery to the agriculture sector continues to be inadequate. It appears that the banking system is still hesitant on various grounds to purvey credit to small and marginal farmers. The situation calls for concerted efforts to augment the flow of credit to agriculture, alongside exploring new innovations in product design and methods of delivery, through better use of technology and related processes. Facilitating credit through institutional sources – commercial banks, cooperatives and RRBs that are vertically integrated with the farmers for providing them critical inputs or processing their produce, could increase the credit flow to agriculture significantly. Agricultural credit is disbursed through a multiagency network consisting of Commercial Banks (CBs), Regional Rural Banks (RRBs) and Cooperatives.. An assessment of agriculture credit situation brings out the fact that the credit delivery to the agriculture sector continues to be inadequate. It appears that the banking system is still hesitant on various grounds to purvey credit to small and marginal farmers. The situation calls for concerted efforts to augment the flow of credit to agriculture, alongside exploring new innovations in product design and methods of delivery, through better use of technology and related processes.

Keywords: Institutional Credit, Agriculture, Credit, Rural development, Small and Marginal farmers, commercial banks, RRBs, Cooperatives.

Backdrop and Objectives of the Study:

The rural credit market appears to be confronted with a paradox. The informal sources of finance, be they local money lenders, landlords, traders, etc., charge more than 20% rate of interest, often keep land as collateral against loan and have a very high recovery rate. On the other hand, rural financial institutions (RFIs) charge almost half of this interest rate, do not take land as collateral for most of the crop loans, and still face high defaults. Where and how rural financial institutions have gone wrong? From the reports of several committees and Task forces on rural credit, it appears that the RFIs, with the sole objective of eliminating informal finance through moneylenders, have always been allowing leniency in their financial policies. The result is that while informal finance still holds significance in the rural areas[1], the RFIs, especially cooperatives are heading towards a state of financial unsustainability.

The main factors behind financial unsustainability of the RFIs are stated to be overwhelming overdues or non-performing assets, high transaction cost, low financial margins and regulated interest rates. Consequent upon these, the RFIs have failed to accumulate enough resource base and are unable to mobilize speedy disbursement of credit in the rural areas[2] . There are also other problems that RFIs have failed to tackle with. These relate to inequality in the distribution of credit among various classes of people and regions, untimely delivery of credit and cumbersome procedures and formalities to transact credit. All these are major cause of concern. Therefore, it is recommended that the RFIs should be strengthened to accelerate the flow of credit to meet the credit demands of the agricultural sector and bring overall development in the rural economy. In this context, it would be worthwhile to explore various policy and institutional measures that have been taken so far for a speedy and timely delivery of credit to the agricultural sector. Before this, it will be useful to examine the magnitude of overdues in the agricultural sector that are likely to be written off. The present study is a step in this direction.

----

1 The AIDIS data show that from 1981 to 1 991, the percentage share of outstanding debt of formal agencies in rural households' has decreased from 61.2% to 56.6% while that of informal agencies has increased marginaJly (RBI Bulletin 2000).

2 The statistics show that against a targeted lending of 18 percent to be given to the priority sector, the proportion of advances to agricultural sector has also declined from 16.9 percent in June 1990 to 14.3 percent in March 1996 (Puhazendhi and Jayaraman 1999).

The Agricultural Credit Policy essentially lays emphasis on augmenting credit flow at the ground level through credit planning, adoption of region-specific strategies, rationalisation of lending policies and procedures and bringing down the cost of borrowing. Bank credit is available to the farmers in the form of short-term credit for financing crop production programmes and in the form of medium-term/long–term credit for financing capital investment in agriculture and allied activities like land development including purchase of land, minor irrigation, farm mechanisation, dairy development, poultry, animal husbandry, fisheries, plantation, and horticulture. Loans are also available for storage, processing and marketing of agricultural produce.

Institutional Arrangements

Agricultural credit is disbursed through a multiagency network consisting of Commercial Banks (CBs), Regional Rural Banks (RRBs) and Cooperatives. There are approximately 100,000 village-level Primary Agricultural Credit Societies (PACS), 368 District Central Cooperative Banks (DCCBs) with 12,858 branches and 30 State Cooperative Banks (SCBs) with 953 branches providing primarily short- and medium-term agricultural credit in India. The long-term cooperative structure consists of 19 State Cooperative Agricultural and Rural Development Banks (SCARDBs), with 2609 operational units as on 31 March 2005 comprising 788 branches and 772 Primary Agricultural and Rural Development Banks (PA&RDBs) with 1049 branches.

Flow of Credit

A comprehensive credit policy was announced by the Government of India on 18 June 2004, containing measures for doubling agriculture credit flow in the next three years and providing debt relief to farmers affected by natural calamities. The following are the highlights of this announcement:

- Credit flow to agriculture sector to increase at the rate of 30 per cent per year.
- Debt restructuring in respect of farmers in distress and farmers in arrears providing for rescheduling of outstanding loans over a period of five years including moratorium of two years, thereby making all farmers eligible for fresh credit.
- Special One-Time Settlement scheme for old and chronic loan accounts of small and marginal farmers.
- Banks allowed to extend financial assistance for redeeming the loans taken by farmers from private moneylenders.
- Commercial Banks (CBs) to finance at the rate of 100 farmers/ branch; 50 lakh new farmers to be financed by the banks in a year.
- New investments in agriculture and allied activities at the rate of two to three projects per branch.
- Refinements in Kisan Credit Cards (KCCs) and fixation of scale of finance.

Government has increasingly begun to tap institutional finance from banks and other term lending institutions for financing various developmental programmes in the State in view of the need to supplement plan financing. Banks in the State have also played a pivotal role in this regard. However, credit should be utilised in a prudent manner to maximize returns and spread the benefit over a wider sections of the population. Successful implementation of socioeconomic developmental programmes calls for effective co-ordination between financial agencies and government departments. It also helps in improvising efficiency of resource allocation & identifying infrastructural gaps. The State Level Bankers' Committee, constituted by the Reserve Bank of India under the Lead Bank Scheme periodically takes up the review performance and monitors progress under special schemes. At the district level the District Consultative Committee with the Chief Executive Officer of Zilla Panchayat as chairperson and representatives of financial institutions and Heads of Government departments at the district level as members monitors the implementation of government sponsored schemes & Service Area Credit Plans. At the block level, Block Level Bankers' Committee chaired by Lead District Manager with bank managers and departmental heads of government at block level as members periodically reviews the implementation of government sponsored schemes & Service Area Credit Plans and sorts out problems encountered in the implementation of various programmes. In order to select & prioritise the works for loan assistance from National Bank for Agriculture and Rural Development(NABARD) under Rural Infrastructure Development Fund(RIDF) Scheme, launched in 1995-96, a Cabinet Sub-Committee on RIDF has been constituted under the chairmanship of the Minister for Public Works. There is also a High Power Committee chaired by the Additional Chief Secretary and Development Commissioner for reviewing the implementation of RIDF projects.

The evolution of institutional credit to agriculture could be broadly classified into four distinct phases - 1904-1969 (predominance of co-operatives and setting up of RBI), 1969-1975 [nationalisation of commercial banks and setting up of Regional Rural Banks (RRBs)], 1975-1990 (setting up of NABARD) and from 1991 onwards (financial sector reforms). The genesis of institutional involvement in the sphere of agricultural credit could be traced back to the enactment of the Cooperative Societies Act in 1904. The establishment of the RBI in 1935 reinforced the process of institutional development for agricultural credit. The RBI is perhaps the first central bank in the world to have taken interest in the matters related to agriculture and agricultural credit, and it continues to do so (Reddy, 2001). The demand for agricultural credit arises due to i) lack of simultaneity between the realisation of income and act of expenditure; ii) lumpiness of investment in fixed capital formation; and iii) stochastic surges in capital needs and saving that accompany technological innovations. Credit, as one of the critical non-land inputs, has two-dimensions from the viewpoint of its contribution to the augmentation of agricultural growth viz., availability of credit (the quantum) and the distribution of credit.

Agricultural Credit: Discernible Trends

In India a multi-agency approach comprising co-operative banks, scheduled commercial banks and RRBs has been followed for purveying credit to agricultural sector. The policy of agricultural credit is guided mainly by the considerations of ensuring adequate and timely availability of credit at reasonable rates through the expansion of institutional framework, its outreach and scale as also by way of directed lending. Over time, spectacular progress has been achieved in terms of the scale and outreach of institutional framework for agricultural credit. Some of the major discernible trends are as follows:

● Over time the public sector banks have made commendable progress in terms of putting in place a wide banking network, particularly in the aftermath of nationalisation of banks. The number of offices of public sector banks increased rapidly from 8,262 in June 1969 to 68,355 by March 2005.

● One of the major achievements in the post-independent India has been widening the spread of institutional machinery for credit and decline in the role of non-institutional sources, notwithstanding some reversal in the trend observed particularly in the 1990s.

● The share of institutional credit, which was little over 7 per cent in 1951, increased manifold to over 68 per cent in 2010, reflecting concomitantly a remarkable decline in the share of non institutional credit from around 93 per cent to about 30 per cent during the same period. However, the latest NSSO Survey reveals that the share of non-institutional credit has taken a reverse swing which is a cause of concern (Table 1).

Table 1: Relative Share of Borrowing of Cultivator Households from Different Sources

(per cent)

Sources	1951	1961	1971	1981	1991	2002	2010
1	2	3	4	5	6	7	8
Non-Instructional of which	**92.7**	**91.3**	**68.3**	**36.8**	**30.6**	**38.9**	**29.7**
Money Lenders	69.7	49.2	36.1	16.1	17.5	26.8	21.9
Institutional of which	**7.3**	**18.7**	**31.7**	**63.2**	**66.3**	**61.3**	**68.8**
Cooperative Societies/Banks	3.3	2.6	22.0	29.8	23.6	30.2	24.9
Commercial Banks	0.9	0.6	2.4	28.8	35.2	26.3	25.1
Unspecified	**-**	**-**	**-**	**-**	**3.1**	**-**	**1.5**
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source : All India Debt and Investment Survey and NSSO.

● Notwithstanding their wide network, co-operative banks, particularly since the 1990s have lost their dominant position to commercial banks. The share of co-operative banks (22 per cent) during 2005-06 was less than half of what it was in 1992-93 (62 per cent), while the share of commercial banks (33 to 68 per cent) including RRBs (5 to 10 per cent) almost doubled during the above period.

● The efforts to increase the flow of credit to agriculture seems to have yielded better results in the recent period as the total institutional credit to agriculture recorded a growth of around 23 per cent during 1995-96 to 2008-09 from little over 14 per cent during 1991-92 to 2008-09. In terms of total credit to agriculture, the commercial banks recorded a considerable growth (from around 43 per cent to about 69 per cent), while cooperative banks registered a fall (over 52 per cent to over 18 per cent) during the above period. There is a considerable increase in RRBs from five percent to 13 per cent (Table 2).

Table 2: Institutional Credit to Agriculture

(Rs.Crores)

Year	Instutitions							
	Cooperative Banks	Share (%)	RRBs	Share (%)	Commercial Banks	Share (%)	Total	Percent Increase
1991-92	5,800	52	596	5	4,806	43	11,202	27
1992-93	9,378	62	831	5	4,960	33	15,169	35
1993-94	10,117	61	997	6	5,400	33	16,494	9
1994-95	9,406	50	1,083	6	8,255	44	18,744	14
1995-96	10,479	48	1,381	6	10,172	46	22,032	18
1996-97	11,944	45	1,684	6	12,783	48	26,411	20
1997-98	14,085	44	2,040	6	15,831	50	31,956	21
1998-99	15,916	43	2,538	7	18,441	50	36,897	15
1999-00	18,363	40	3,172	7	24,733	53	46,268	25
2000-01	20,801	39	4,219	8	27,807	53	52,827	14
2001-02	23,604	38	4,854	8	33,587	54	62,045	17
2002-03	23,716	34	6,070	9	39,774	57	69,560	12
2003-04	26,959	31	7,581	9	52,441	60	86,981	25
2004-05	31,424	25	12,404	10	81,481	65	1,25,309	44
2005-06	39,404	22	15,223	8	1,25,859	70	1,80,486	44
2006-07	33,987	24	15,170	10	1,00,999	67	1,50,156	49
2007-08	35,875	20	17,987	10	1,28,876	70	1,82,738	51
2008-09	36,165	19	19,325	10	1,32,761	71	1,88,251	53
2009-10	32,871	18	23,984	13	1,21,879	69	1,78,734	--

Note : Commercial Banks and RRBs were clubbed together up to 1990-91.
Source : Economic Survey and NABARD various issues.

However, the growth of direct finance to agriculture and allied activities witnessed a decline in the 1990s[3] (12 per cent) as compared to the 1980s (14 per cent) and 1970s (around 16 per cent). Furthermore, a comparative analysis of direct credit to

[3] 1990s referred wherever covers the period from 1990-91 to 2001-02, the latest year for which the data are available.

agriculture and allied activities during 1980s and since 1990s reveals the fact that the average share of long-term credit in the total direct finance has not only been much lower but has also decelerated (from over 38 per cent to around 36 per cent), which could have dampening effect on the agricultural investment for future growth process.

- The disaggregated picture as per size-wise distribution of credit reveals that the growth of direct finance to small and marginal farmers witnessed a marked deceleration from about 24 per cent in the 1980s to little over 13 per cent during the 1990s.

- Sectoral deployment of gross bank credit reveals that the share of agriculture since the second half of 1990s has ranged between 11-12 per cent. As at end March 2010, the share stood at around 13 per cent (Table 3).

Table-3: Sectoral Deployment of Gross Bank Credit

(Rs.in Crores)

Sectors	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2009-10
Gross Bank Credit	258991	300283	342012	400818	469153	536727	669534	764383	1040909	1445837	2045897
A. Priority Sector	84880	99,507	114611	131827	154414	175259	211609	263834	381476	509910	876459
I. Agriculture	31442	34869	39643	44381	51922	60761	73518	90541	125250	172279	267840
Share of Agriculture in Total	**12.14**	**11.61**	**11.59**	**11.07**	**11.07**	**11.32**	**10.98**	**11.84**	**12.03**	**11.92**	**13.09**
II.SmallScale Industries	35944	43508	48483	52841	56002	57119	60.394	65855	74588	90239	209679
III.OtherPriority Sector	17494	21130	26494	34362	46490	57299	77697	107438	181638	247379	379430
B. Industry	102604	117350	130516	147319	162837	172324	235168	247210	352304	458808	698560
Share of Industry in Total	**39.62**	**39.08**	**38.16**	**36.75**	**34.71**	**32.11**	**35.12**	**32.34**	**33.85**	**31.75**	**32.57**

Source : Report on Trend and Progress of Banking in India, Various issues.

State-wise Distribution of Institutional Credit

There are wide variations in the availability of institutional credit per hectare of gross cropped area in different States. It was as high as Rs.9,403 in Tamil Nadu, Rs.7, 666 in Kerala, Rs.5,352 in Punjab and Rs.4,604 in Andhra Pradesh, while it was as low as Rs.311 in Assam, Rs.667 in Rajasthan and Rs.698 in Madhya Pradesh during 2001-02 (Table 4).

Table 4: Distribution of Flow of Institutional Agricultural Credit in Different States of India

Region/States	1990-91		2001-02		Annual Increase (%)	%of GCA (1998-99)	Rs/hectare GCA		Annual Increase (%)
Northern	1314	12.9	8236	19.9	43.9	20.25	377	2132	38.9
Punjab	642	6.3	4304	10.4	47.5	4.22	856	5352	43.8
Haryana	285	2.8	1821	4.4	44.5	3.22	482	2964	42.9
Rajasthan	326	3.2	1490	3.6	29.7	11.70	168	667	24.7
Himachal Pradesh	20	0.2	248	0.6	93.2	0.51	207	2555	94.5
Jammu & Kashmir	20	0.2	83	0.2	25.5	0.57	191	764	25.0
North-Eastern	41	0.4	207	0.5	34.0	2.90	96	374	31.4
Assam	20	0.2	124	0.3	42.4	2.09	54	311	39.9
Eastern	846	8.3	3062	7.4	21.8	14.71	463	1092	22.8
Orissa	306	3.0	414	1.0	3.0	4.53	319	479	4.2
West Bengal	285	2.8	1573	3.8	37.6	4.83	329	1708	34.9
Bihar(including Jharkhand)	245	2.4	1076	2.6	28.3	5.25	233	1075	30.1
Central	1722	16.9	5835	14.1	19.9	27.57	349	1110	18.2
Madhya Pradesh (including Chhatishgarh)	746	7.5	1821	4.4	11.5	13.67	320	698	9.9
Urrar Pradesh(Including Uttarchanchal)	958	9.4	4056	9.8	27.0	13.90	376	1529	25.6
Western	1386	13.6	5959	14.4	27.5	7.06	430	1831	27.4
Guarat	520	5.1	2980	7.2	19.5	5.56	501	2809	38.3
Maharashtra	846	8.3	2938	7.1	20.6	11.40	387	1353	20.8
Southern	4880	47.9	18127	43.8	22.6	17.51	1410	5426	23.8
Andrapradesh	1477	14.5	5587	13.5	23.2	6.63	1120	4604	25.9
Karnataka	642	6.3	4041	9.7	43.8	6.13	546	3432	44.1
Kerala	835	8.2	2276	5.5	14.4	1.56	2766	7666	14.8
Tamil Nadu	1895	18.6	6166	14.9	18.8	3.44	2857	9403	19.1
All-India	10188	100.0	41385	100.0	25.5	100.0	549	2169	24.6

GCA refers to gross cropped area.
Source : Report of the Advisory Committee on Flow of Credit to Agriculture and Related Activities from the
Banking System, RBI, Mumbai, 2004.

The accessibility to institutional credit is higher in the Southern region where the level of agricultural development is also higher. Similar results were reported in the studies conducted earlier during the 1980s (Rao, 1994). It is kind of vicious cycle operating in less developed States. Less availability of credit influences adversely the adoption of modern technology and private capital investments, which in turn lowers the productive capacity of the agricultural sector and results in lower productivity and production, and also pushes the farmers to borrow from non-institutional sources. Consequently, the demand for agricultural credit for short and long-term purposes is dampened.

The extent of deployment of credit out of deposits in a given State could be measured by Credit-Deposit Ratio (CDR). The proportion of districts having CDR less than 40 is higher (66 per cent) in less developed States as compared to the developed States (32 per cent) indicating growing migration and wide disparities in the deployment of credit in major States (Table 5).

Table 5: Credit Deposit Ratio in Major States

(Rupees in crores)

Description	No. Of states	No. Of districts	<40	40-50	>50
States with per capita SDP Less than average	9	196 (100)	129 (66)	26 (13)	41 (21)
States with per capita SDP More than national average	11	187 (100)	60 (32)	33 (18)	94 (50)
Total	**20**	**383 (100)**	**189 (50)**	**59 (15)**	**134 (35)**

Figures in the brackets represent percentages. Credit is taken on utilization basis.
Source : Report of the Expert Group on Investment Credit, RBI, 2005.

During Tenth Five Year Plan, the total credit flow to agriculture and allied activities was projected at Rs.7,36,570 crore. Accordingly, the ground level credit flow to agriculture has grown to reach over Rs.2,60,540 crore (36 per cent of the projected level) during the first three year period (2002-03 to 2004-05) of Tenth Plan, indicating a wide gap in supply of credit, requiring a large increase in credit, particularly in investment credit to achieve the desired growth level.

Recent Policy Initiatives

There are many rural infrastructure projects which have been started but are lying incomplete for want of resources. They represent a major loss of potential income and employment to rural population." Rural Infrastructure Development Fund (RIDF) was set up in NABARD[4]. Since then, 11 tranches of allocations have been made towards the Fund. Commercial banks make contributions towards the Fund on account of the shortfalls in their priority/agriculture sector lending. The scope of RIDF has been widened to enable utilisation of loan by Panchayati Raj Institutions (PRIs), Self-Help Groups (SHGs), Non-Government Organisations (NGOs), etc., since 1999-2000.

The Fund has continued with additional corpus being announced every year in the Union Budget. The RIDF XI was announced in the Union Budget for 2005-06 with an allocation of Rs.8,000 crore making a total corpus of Rs.78,300 crore. RIDF XI accorded special emphasis for setting up of Village Knowledge Centres by providing Rs.100 crore out of the corpus of Rs.78,300 crore (Table 6).

---

[4] RIDF was setup under the initiative of the Government of India in 199596 with an initial corpus of Rs.2,000 crore to provide loans to State Governments for financing rural infrastructure projects.

Table 6: RIDF: Tranche-wise Size of Corpus

(Rs. crore)

RIDF Tranche	Year	Corpus
RIDF I	1995-96	2000
RIDF II	1996-97	2500
RIDF III	1997-98	2500
RIDF IV	1998-99	3000
RIDF V	1999-2000	3500
RIDF VI	2000-2001	4500
RIDF VII	2001-2002	5000
RIDF VIII	2002-2003	5500
RIDF IX	2003-2004	5500
RIDF X	2004-2005	8000
RIDF XI	2005-2006	8000
RIDF XII	2006-2007	9000
RIDF XIII	2007-2008	9500
RIDF XIV	2008-2009	9800
Total	--	78300

Source: 1. NABARD Annual Report
2. RBI Bulletin

Two innovations, viz., micro-finance and Kisan Credit Card Scheme (KCCS) have emerged as the major policy developments in addressing the infirmities associated with the distributional aspects of credit in the recent years. The KCCS has emerged as the most effective mode of credit delivery to agriculture in terms of the timeliness, hassle-free operations as also adequacy of credit with minimum of transaction costs and documentation. Around 59.09 million KCCs were issued till end-March 2006. The cooperative banks (51.5 per cent) had a major share followed by commercial banks (36.9 per cent) and RRBs (11.6 per cent) (Table 7).

Table 7: Agency-wise and Year-wise KCC

(Numbers in Millions)

Year	Cooperative Banks	RRBs	Commercial Banks	Total
1998-99	0.16	0.01	0.62	0.78
1999-2000	3.6	0.17	1.37	5.13
2000-2001	5.61	0.56	2.39	8.65
2001-2002	5.44	0.83	3.07	9.34
2002-2003	4.58	0.96	2.70	8.24
2003-2004	4.88	1.27	3.09	9.25
2004-2005	3.56	1.73	4.40	9.68
2005-2006	2.60	1.25	4.17	8.01
2006-2007	3.80	1.76	4.54	9.54
2007-2008	3.96	1.95	4.21	10.45
2008-2009	4.65	1.99	4.64	10.98
Total	**42.82**	**12.58**	**35.19**	**90.59**
Share in Total(Per cent)	**47.28**	**13.87**	**38.85**	**100.0**

Source : Report on Trend and Progress of Banking in India, RBI.

The micro credit programme, which was formally heralded in 1992 with a modest pilot project of linking around 500 SHGs has made rapid strides in India exhibiting considerable democratic functioning and group dynamism. The programme has now assumed the form of a micro finance movement in many parts of the country. There was a massive expansion during 2004-05 with the banking system establishing credit linkage with 539 thousands new SHGs, taking the cumulative number of such SHGs to 4.8 million at end March 2009. Banks extended loans aggregating Rs. 22456 crore at end-March 2009 registering a growth of 58.3 per cent over the previous year (Table 8).

Table 8: SHG-Bank Linkage Programme

Year	Total SHGs Financed by Banks Number in '000		Banks Loans (Rs.Crores)		Refinance (Rs. Crore)	
	During the year	Cumulative	During the Year	Cumulative	During the Year	Cumulative
1999-2000	81.78 (147.9)	114.78 (247.9)	136 (138.6)	193 (238.6)	98 (88.5)	150 (188.5)
2000-2001	149.05 (82.3)	263.83 (129.9)	288 (111.8)	481 (149.2)	251 (156.1)	401 (167.3)
2001-2002	197.65 (32.6)	461.48 (74.9)	546 (89.6)	1026 (113.3)	396 (57.8)	797 (98.8)
2002-2003	255.88 (29.5)	717.36 (55.4)	1022 (87.2)	2049 (99.7)	622 (57.1)	1419 (78.0)
2003-2004	361.73 (41.4)	1079.09 (50.0)	1856 (81.6)	3904 (90.5)	705 (13.3)	2125 (49.7)
2004-2005	539.39 (49.1)	1618.48 (50.0)	2994 (61.4)	6899 (76.7)	968 (37.3)	3092 (45.5)
2005-2006	620 (15.0)	2239 (38.3)	4449 (50.3)	11398 (65.2)	1068 (10.3)	4160 (34.5)
2006-2007	686 (11.0)	2924 (30.6)	6643 (47.6)	18041 (58.3)	1299 (21.6)	5459 (31.2)
2007-2008	798 (13.4)	3456 (45.3)	7829 (51.4)	20342 (61.6)	1467 (26.1)	6098 (36.2)
2008-2009	824 (14.3)	4812 (37.5)	8735 (61.5)	22456 (56.4)	1642 (23.5)	7541 (34.7)

Notes : 1. Figures in parentheses indicate percentage variations over the previous year.
2. Data for 2008-09 are provisional.

Source: Report on Trend and Progress of Banking in India, various issues.

Several Committees were set up from time to time to look into the various issues relating to credit delivery for agriculture, the recent one being Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (Chairman: Prof. V.S. Vyas, June, 2004) [5]

The Government has since approved rehabilitation package for the identified districts in the States of Andhra Pradesh, Karnataka, Kerala, and Maharashtra. Altogether, the rehabilitation package for the four States involves a total amount of Rs.16,978 crore consisting of Rs.10,579 crore as subsidy/grants and Rs.6,399 crore as loan. In order to give further fillip to micro-finance movement, the RBI has enabled Non-Governmental Organisations (NGOs) engaged in micro-finance activities to access external commercial borrowings (ECBs) up to US $ 5 million during a financial year for permitted end-use, under automatic route, as an additional channel

---

5
32 recommendations (out of 99 recommendations made by the Committee) have been accepted and implemented by the Reserve Bank.

of resource mobilisation. Besides, as a follow-up of the Union Budget proposals, modalities for allowing banks to adopt the agency model for providing credit support to rural and farm sectors and appointment of micro-finance institutions (MFIs) as banking correspondents are also worked out.

The Government of India announced a host of measures in June 2004 to double the flow of agricultural credit during the period 200405 to 2006-07 by all the financial institutions. Towards this end, it was proposed to increase the agricultural credit by 30 per cent to about Rs.1.05 lakh crore in 2004-05. While the target set for 200405 was achieved, the Union Budget for 2005-06 proposed to increase the credit flow to agriculture by another 30 per cent by all the institutions concerned. The Reserve Bank has undertaken several policy initiatives in pursuance of the objective set in the Union Budget 2004-05 to achieve a doubling of flow of credit to agriculture. On the issue of farmers' suicide in the country, the Government has realised that indebtedness is one of the major reasons for suicide by farmers in the country. To prevent and save the farmers from the clutches of private money lenders, several measures were taken. Banks were advised in particular :

i) To increase the agricultural credit flow at the rate of 30 per cent per year.
ii) To restructure the outstanding debt of the farmers under the following heads in accordance with the guidelines issued by RBI/ NABARD:

- Farmers in distress – Rescheduling/restructuring of the outstanding loan of the farmers as on March 31, 2004 in the districts declared as calamity – affected by the State Government. Rescheduled loan shall be repayable over a period of five years, at current interest rates, including an initial moratorium of two years.
- Farmers in arrears - Loans in default of farmers who have become ineligible for fresh credit as their earlier debts have been categorised as sub-standard or doubtful shall be rescheduled as per the guidelines so that such farmers become eligible for fresh credit.

iii) To grant a one-time settlement (OTS) including partial waiver of interest or loan to the small and marginal farmers who have been declared as defaulters and have become ineligible for fresh credit. Banks have also been advised to review cases where credit has been denied on the sole ground that a loan account was settled through compromise or write offs.

iv) In some parts of the country, farmers face acute distress because of the heavy burden of debt from non-institutional lenders (e.g., moneylenders). Banks have been permitted to advance loans to such farmers to provide them relief from indebtedness.

v) All the Public Sector banks have been advised to reduce their lending rate for agriculture to a single digit rate of not more than 9 per cent per annum on crop loans upto a ceiling of Rs.50,000. This rate will benefit most of the crop loan account holders and will cover almost all the small and marginal farmers.

vi) To waive margin/security requirements for agricultural loans up to Rs.50,000 and agri-business and agri-clinics up to Rs.5 lakhs.

With a view to further increasing the flow of credit to agriculture, several measures were announced by RBI in its Annual Policy Statement 2005-06. These include i) setting up of an Expert Group to formulate strategy for increasing investment in agriculture, ii) conducting a survey with the help of an outside agency to make an assessment of customer satisfaction on credit delivery in rural areas by banks, iii) to increase the limit on loans to farmers through the produce marketing scheme from Rs.5 lakh to Rs.10 lakh under priority sector lending.

Special Rehabilitation Package for the Districts Severely Affected by Farmers' Suicide

The incidents of suicide by farmers have been mainly reported from the States of Andhra Pradesh, Karnataka, Maharashtra, and Kerala. Such incidents have also been reported from the States of Orissa, Gujarat, and Punjab. To mitigate the distress of farmers, the Government of India decided to launch a special rehabilitation package in 31 Districts in the States of Maharashtra, Andhra Pradesh, Karnataka, and Kerala. The 31 Districts were identified based on the severity and magnitude of the incidence of farmers' suicide, as reported by the State Governments. The intent is to initially solve the problem and correct the situation in those areas reporting high number of suicides so that an effective dent on the problem is made and the incidence of farmers' suicide which is of national concern could be curbed.

The package aims at establishing a sustainable and viable farming and livelihood support system through debt relief to farmers, improved supply of institutional credit, crop-centric approach to agriculture, assured irrigation facilities, watershed management, better extension and farming support services, improved marketing facilities and subsidiary income opportunities through horticulture, livestock, dairying, fisheries. For alleviating the hardships caused to debt stressed families of farmers in the affected districts, ex-gratia assistance from Prime Minister's National Relief Fund (PMNRF) was also proposed.

Issues and Concerns

Despite the significant strides achieved in terms of spread, network and outreach of rural financial institutions, the quantum of flow of financial resources to agriculture continues to be inadequate. One of the major impediments constraining the adoption of new technological practices, land improvements and building up of irrigation and marketing infrastructure has been the inadequacy of farm investment capital. Farmers seem to borrow more short-term credit in order to meet input needs to maintain continuity in agricultural operations without much worrying about long-term capital formation in the face of agricultural bountiness. It might be the case from supply side that short-term credit bears low credit risk, lower supervision and monitoring costs, and a better asset liability management. The flow of investment credit to agriculture is constrained by host of factors such as high transaction costs, structural deficiencies in the rural credit delivery system, issues relating to credit worthiness, lack of collaterals in view of low asset base of farmers, low volume of loans with associated higher risks, high man power requirements, etc.

The large proportion of population in the lower strata, which is having major share in the land holdings receives much less credit than its requirements. The growing disparities between marginal, small and large farmers continues to be a cause for concern. This observed phenomenon may be attributed, inter alia, to the "risk aversion" tendency of the bankers towards small and marginal farmers as against the large farmers, who are better placed in offering collaterals.

Notwithstanding the rapid spread of micro-finance programme, the distribution of SHGs is skewed across the States. More than 50 per cent of the total SHG credit linkages in the country are concentrated in the Southern States. In the States, which have a larger share of the poor, the coverage is comparatively low. The tragic incidents of farmers' suicides in some of the States have been a matter of serious concern. A study was conducted in some regions of Andhra Pradesh to go into the causes of such tragedies and to suggest short and long term measures to prevent such unfortunate incidents. The study has identified crop losses, consecutive failure of monsoon, recurrent droughts, mounting debts, mono-cropping, land tenancy, as some of the main causes which led many distressed farmers to commit suicide. Of the total number of suicide cases reported, 76 per cent of the victims were dependent on rain-fed agriculture and 78 per cent were small and marginal farmers. An important finding of the study was that 76 to 82 per cent of the victim households had borrowed from non-institutional sources and the interest rates charged on such debts ranged from 24 to 36 per cent. The study has recommended several measures to tackle the situation. These include improvement irrigation overage; crop diversification; promotion of animal husbandry as an alternate source of income; better accessibility to institutional credit and overall improvement of the marketing infrastructure.

Implications for the Future

Indian agriculture still suffers from: i) poor productivity, ii) falling water levels, iii) expensive credit, iv) a distorted market, v) many intermediaries who increase cost but do not add much value, vi) laws that stifle private investment, vii) controlled prices, viii) poor infrastructure, and ix) inappropriate research. Thus the supply leading approach with mere emphasis on credit in isolation from the above factors will not help agriculture to attain the desired growth levels. Furthermore, agriculture being a State subject, States are required to play a more pro-active role in agriculture development by putting in place adequate infrastructure through means such as RIDF.

As noted above, the share of marginal and small farmers in the total credit (both disbursed and outstanding) has been shrinking. The need to augment the credit flow to the lower strata of the farming community, which has more share in the total operational land holdings becomes all the more important. This underscores the scope for supplementing the land inputs of marginal and small farmers with the non-land inputs such as credit with a view to enhancing the productivity and thereby the production performance of Indian agriculture. In this context, the need for linking credit supply to input use assumes importance. There is also a need for exploring new innovations in product design and methods of delivery, through better use of technology and related processes. It needs to be seen whether credit going to farmers especially small and marginal is in sufficient quantity and if so whether it will have any meaningful effect in the absence of other supportive measures for ensuring their economic viability. In this context, creation of production and employment opportunities in the rural sector through public investment assumes critical importance. The SHG-Bank Linkage model is an outstanding example of an innovation leveraging on community-based structures and existing banking institutions. In future, concerted efforts have to be made for enhancing the flow of credit to critical infrastructure areas such as irrigation, marketing and storage, etc., and also to areas such as watershed/ wasteland development, wind energy, allied activities such as poultry, horticulture, dairying, etc.

With regard to KCCS, there is a need to upscale its outreach to cover all the eligible farmers by creating greater awareness and giving greater publicity to the scheme. Updation of land records and sensitisation of bank staff through training programmes will further add to the spread of the scheme. The exercise of preparing special agricultural credit plans with higher component of direct finance with a special thrust on small and marginal farmers should also receive high priority.

The success of KCC scheme depends on less stipulated norms. High value agriculture needs higher working capital and also entails higher risks. Facilitating credit through processors, input dealers, NGOs, that are vertically integrated with the farmers, including through contract farming, for providing them critical inputs or processing their produce, could increase the credit flow to agriculture significantly.

Concluding Observations

The co-operative credit structure needs revamping to improve efficiency of the credit delivery system in rural areas. In case of co-operatives, the Vaidyanathan Committee concluded that having regard to its outreach and potential, recapitalisation could be undertaken so that the credit channels for agricultural credit which are presently choked could be declogged. The Committee has, however, made it clear that recapitalisation should only be considered if it is preceded by legal and institutional reforms by State Governments aimed at making co-operatives democratic and vibrant institutions running as per sound business practices, governance standards and regulated at the upper tiers by the RBI. In this connection, it may be suggested that the State Governments' performance in bringing about the reforms in co-operative banks should form one of the yardsticks for sanctioning assistance/grants by the Central Government. The competition and search for higher returns has made commercial banks to explore profitable avenues and activities for lending such as financing of contract farming, extending credit to the value chain, financing traders and other intermediaries, which needs to be encouraged. While the institutional systems and products such as futures markets, and weather insurance have great potential to minimise the risk of lending, the process of their development needs to be carried forward.

Merging and revamping of RRBs that are predominantly located in tribal/backward regions is seen as a potentially significant institutional arrangement for financing the hitherto unreached population. Such an exercise is currently on and the State Governments and Sponsor Banks have to come together and cooperate in this area. The experience of micro finance proved that the "poor are bankable" and they can and do save in a variety of ways and the creative harnessing of such savings is a key success factor. The SHGBank linkage programme is built upon the existing banking infrastructure; it has obviated the need for the creation of a new Institutional set-up or introduction of a separate legal and regulatory framework.

Policy making bodies have an important role in creating the enabling environment and putting appropriate policies and interventions in position, which enable rapid up scaling of efforts consistent with prudential practices. There is also a need to explore the possibility how SHGs can be induced to graduate into matured levels of enterprise. The SHG Bank Linkage programme also needs to introspect whether it is sufficient or SHGs to only meet the financial needs of their members, or whether there is a further obligation on their part to meet the nonfinancial requirements necessary for setting up business and enterprises.

In the process, ensuring the quality of SHGs warrants priority attention. State Governments have to make critical assessment of the manpower and skill sets available with them for forming, and nurturing groups and handholding and maintaining them over time. There is a need to study the best practices in the area and evolve a policy by learning from them. Since, the access of small and marginal Farmers to credit has been constrained by their inability to offer the collaterals, micro finance, which works on social collaterals, can go a long way in catering to their requirements. Hence, there is need to promote micro finance more vigorously on a widespread basis.

An assessment of agriculture credit situation brings out the fact that the credit delivery to the agriculture sector continues to be inadequate. It appears that the banking system is still hesitant on various grounds to purvey credit to small and marginal farmers. The situation calls for concerted efforts to augment the flow of credit to agriculture, alongside exploring new innovations in product design and methods of delivery, through better use of technology and related processes.

The RFIs have used incentives to ensure financial discipline and to build a positive relationship between the lender and borrowers. The two Indonesian RFIs have offered a monthly interest rebate on the original loan value for timely repayments. The BAAC, by contrast, has preferred to impose a penalty rate of three per cent a year on arrears. The rigid pattern of frequent payment, buttressed by routine meetings of the group members in BAAC, Commercial banks, cooperatives and Regional Rural Banks are considered to be useful in achieving financial discipline and reducing administrative costs. All the rural financial institutions - Commercial banks, cooperatives and Regional Rural Banks have used components of mobile banking as an innovative way to provide low-cost savings and lending services to very poor clients. This practice has greatly reduced transaction costs for both the lenders and borrowers.

Selected References

Akhavein, J.D., Berger, A.N., Humphrey, D.B. (1997): "The Effects of Megamergers on Efficiency and Prices: Evidence from a Bank Profit Function", Finance and Economic Discussion Series 9, Board of Governors of the Federal Reserve System.

Arellano, M., and Bover, O. (1995): "Another Look at the Instrumental Variables Estimation of Error Components Models," Journal of Econometrics, 68, pp.29–51.

Athanasoglou Panayiotis P., Brissimis Sophocles N. and Delis Matthaios D. (2005): "Bank- Specific, Industry-Specific and Macroeconomic Determinants of Bank Profitability", Bank of Greece Working Paper No. 25.

Balachandher K G, John Staunton and Balashanmugam (2004): "Determinants of Commercial Bank Profitability in Malaysia" Papers presented at the 12 Annual Australian Conference on Finance and Banking.

Barth, J.R., Caprio, G., Levine, R. (2004): "Bank supervision and regulation: What Works Best?" Journal of Financial Intermediation, 13 (2), pp.205-248.

Benston, George J., Gerald A. Hanweck and David B. Humphrey (1982): "Scale Economies in Banking", Journal of Money, Credit, and Banking, Vol.XIV, No. 4, part 1, November.

Bikker, J.A., Hu, H. (2002): "Cyclical Patterns in Profits, Provisioning and Lending of Banks and Procyclicality of the New Basel Capital Requirements", BNL Quarterly Review, 221, pp.143-175.

Bell Frederick W. and Nell Mushy (1969): "Impact of Market Structure on the Price of a Commercial Banking Service", The Review of Economics and Statistics, May.

Bose, Sukanya (2005): "Regional Rural Banks: The Past and the Present Debate", Macro Scan, URL: http://www.macroscan.com/fet/jul05/fet200705RRB_Debate.htm.

Bourke, P. (1989): "Concentration and other Determinants of Bank Profitability in Europe, North America and Australia", Journal of Banking and Finance, Vol.13, pp. 65-79.

Consideration of the Regional Rural Banks (Amendment) Bill, 2004, Proceedings Other Than Questions and Answers, XIV Lok Sabh.

Das Prasant (2000): "Sustainability Through Outreach - The Malbar Lighthouse Shows the Way." National Seminar on Best Practices in RRBs, BIRD, Lucknow.

Demirguc-Kunt, A., Huizinga, H. (2000): "Financial Structure and Bank Profitability", World Bank, Mimeo.

Demirguc-Kunt, A., Maksimovic, V. (1998): "Law, Finance and Firm Growth", Journal of Finance, 53(6), pp.2107-2137.

Devaraja T S.,(1999): "Working of District Central Co-operative Bank, Hassan Karnataka: An Analysis" Indian Co-operative Review, VOL.XXXVI, No.3, pp. 39-44.

Devaraja T S., (1999): "Role of Agricultural Development Branch (State Bank of Mysore) in Financing Agriculture –A Study", Land Bank Journal, Vol XXIV No.8, pp.56-67.

Devaraja T S., (1999): "Performance Evaluation of Sharada Mahila Cooperative Bank Ltd., in Mysore City of Karnataka", Maharastra Cooperative, Quarterly, Vol. XXXIV. No. 13, pp. 45-53.

Devaraja T S., (1999):" Working of District Cooperative Central Bank, Hassan, Karnataka-An Econometric Evaluation", The Maharastra Co-operative Quarterly, Vol. LXXXIII, No.2, pp.28-34.

Devaraja T S., (2003):" A Study of Indirect Financing by Regional Rural Banks(RRBs) in Karnataka – An Economic Analysis", Agricultural Marketing, Vol. XLVI. No.3, pp.98-103.

Edwards. Franklin R. (1977): "Managerial Objectives in Regulated Industries: Expense Preference Behavior in Banking", Journal of Political Economy, February.

Goddard, J., Molyneux, P., Wilson, J.O.S. (2004): "The Profitability of European Banks: A Cross-Sectional and Dynamic Panel Analysis", Manchester School 72 (3), pp.363- 381.

Haslem, John (1968): "A Statistical Analysis of the Relative Profitability of Commercial Banks", Journal of Finance, Vol. 23, pp.167-176.

Hausman, Jerry A. (1978): "Specification Tests in Econometrics," Econometrica, 46, pp.1251–1272.

Joshi V.C. and Joshi V.V. (2002): "Managing Indian Banks", Response Books, New Delhi.

Kwast, Myron L. and John T. Rose (1982), " Pricing, Operating Efficiency and Profitability Among Large Commercial Banks", Journal of Banking and Finance,Vol.6.
Malhotra, Rakesh (2002): "Performance of India's Regional Rural Banks (RRBs): Effect of the UmbilicalCord".URL: http://www.alternativefinance.org.uk/rtf/rrbsmalhotra.rtf.

Miller, S.M., Noulas, A.G. (1997): "Portfolio Mix and Large-bank Profitability in the USA", Applied Economics, 29 (4), pp.505-512.

Mohan Jagan (2004): "Regional Rural Banks Need a Shot in the Arm", Financial Daily from The Hindu Group of Publications. March 19 Edition.

Molyneux, P., Thornton, J. (1992): "Determinants of European Bank profitability: A Note", Journal of Banking and Finance, Vol.16, pp.1173-1178.

Nitin Bhatt and Thorat Y. S. P. (2004): "India's Regional Rural Banks: The Institutional Dimension of Reforms", National Bank News Review, NABARD, April-September.

Neely, M.C., Wheelock, D.C. (1997), "Why Does Bank Performance Vary Across States? Review", Federal Reserve Bank of St. Louis, Vol 79, No. 2, pp. 27-40.

Perry, P., (1992): "Do Banks Gain or Lose from Inflation", Journal of Retail Banking, 14(2), pp.25-30.

Reddy, Y.V. (2000): "Future of Rural Banking" Address at Prof. G. Rama Reddy's Third Endowment Lecture, Hyderabad, Reserve Bank of India Bulletin, January.

Reddy, Y.V. (2000): "Rural Credit: Status and Agenda", Reserve Bank of India Bulletin, November.

Report on Trends and Progress of Banking in India (Various Issues), Reserve Bank of India, Mumbai. URL: (www.rbi.org.in).

Reserve Bank of India (2004): "Report of the Advisory Committee on Flow of Credit to Agriculture and Related Activities From the Banking System". URL: (www.rbi.org.in).

Reserve Bank of India (2005): "Report of the Internal Working Group on RRBs", Chairman: A.V. Sardesai, Mumbai. URL: (www.rbi.org.in).

Reserve Bank of India (2002): "Annual Accounts of Scheduled Commercial Banks in India (1989-2001)", Mumbai. URL: (www.rbi.org.in).

Revell, J., (1979): "Inflation and Financial Institutions", Financial Times, London.

Rhoades, Stephen A.1977): "Structure and Performance Studies in Banking: A Summary and Evaluation", Staff Economics Studies 92, Federal Reserve Board, Washington, DC.

Schuster, Leo (1984): "Profitability and Market Share of Banks", Journal of Bank Research, Spring.

Shaffer, S. (1994): "Bank Competition in Concentrated Markets", Federal Reserve Bank of Philadelphia Business Review, March/April, pp.3-16.

Shaffer, S. (2004): "Comment on "What Drives Bank Competition? Some International Evidence" by Stijn Claessens and Luc Laeven, Journal of Money, Credit, and Banking, Vol.36, pp.585-592.

Sharma K.C; Josh P.; Mishra J.C.; Kumar Sanjay; Amalorpavanathan R.and Bhaskran R. (2001): "Recovery Management in Rural Credit", Occasional Paper, No. 21, NABARD, Mumbai.

Short, Brock (1977): "Bank Concentration, Market Size and Performance: Some Evidence From Outside the United States", Mimeo, IMF, Washington, DC.

Short, B.K. (1979): "The Relation Between Commercial Bank Profit Rates and Banking Concentration in Canada, Western Europe and Japan", Journal of Banking and Finance, Vol.3, pp.209-219.

Smirlock, M. (1985): "Evidence on the (non) Relationship Between Concentration and Profitability in Banking", Journal of Money, Credit, and Banking, Vol. 17, pp. 69-83.

Staikouras, C., Steliaros, M. (1999): "Factors That Determine the Profitability of the Greek Financial Institutions". Hellenic Bank Association, 19, pp.61-66.

Statistical Tables Relating to Banks in India (Various Issues), Reserve Bank of India, Mumbai. URL: (www.rbi.org.in)

Thingalaya N.K. (2000): "The Other Side of the Rural Banking", BIRD, Lucknow.

Velayudham, T. K., and Sankaranarayanan, V. (1990): "Regional Rural Banks and Rural Credit: Some Issues", Economic and Political Weekly, September 22, pp.2157-2164.

Tschoegl, Adrian E. (1982): "Concentration Among International Banks A Note", Journal of Banking and Finance, Vol.6.

Tschoegi, Adrian E. (1983): "Size, Growth and Transnationality Among the World's Largest Banks", Journal of Business, 56, No. 2.