



## **AGRICULTURE CREDIT: BANKING SECTOR REFORMS IN INDIA DURING PRE AND POST REFORMS PERIOD**

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**Abstract:** With the modernization of agriculture in the mid-1960s, the demand for short-term and long-term agricultural credit started rising at a rapid rate as the farmer has to purchase costly inputs like fertilizers, HYV seeds, pesticides, etc. from the market. Capital, together with scientific knowledge, played a very significant role in increasing the productivity of agriculture. This had shifted the government's attention from co-operative based approach to state-owned banks to create an alternative source of finance to free the farmers from the grip of moneylenders. Several committees/working groups/task forces had been formed to go through the financial aspects of rural financial institutions. The Narasimham Committee brought about various measures in the area of agricultural credit such as deregulation of interest rates, abolition of branch licensing, gradual phasing out of directed credit programmes, closing down of loss-making bank branches and so on. The Committee was of the view that easy and timely access to credit was far more important than its cost. Agriculture finance plays a major role in India.

**Keywords:** Agricultural credit, pre& post reforms, banking sector reforms.

## **Introduction**

Agriculture is the first culture that man learnt to practice as a means of living and a way. However, with the advancement of knowledge, culture and civilization the place, pattern practices and potentialities of agriculture, have been continually undergoing a process of transformation. From a mere primitive way of life and a source of livelihood, it has come to be realized as a commercialized activity and profitable business proposing a vital instrument of progress. In India, the vital role of agriculture arises out of the position. The agrarian sector occupies in the overall economy of the country. Agriculture is the largest sector of the economic activity and has a crucial role to play in the country's economic development by providing food and raw material, employment to a very large proportion of population, capital for its own development and surpluses for the national economic development. Thus, the importance of agriculture, despite rapid industrialization, has not anyway diminished. It has become necessary not only to achieve self-sufficiency in matters of food and agricultural raw material, but to highly modernize agriculture so as to throw up surplus to be made available for investment in the other sectors of economy as well.<sup>1</sup> Since the introduction of green revolution in India, there has been a growing tendency among the farmers to replace the traditional farming with scientific and modern techniques which includes the use of improved seeds, fertilizers and irrigation facilities. These inputs involve heavy financial investment which the majority of farmers cannot afford from their own savings. In the initial stages, agricultural credit was being provided by non-institutional sources like moneylenders, traders, relatives etc. Due to exploitative nature of non-institutional sources, the formal banking system was encouraged and

got entered into the rural market. Among many inputs, credit is considered as an important input for the development of agriculture. The role of credit in agriculture has been pointed by many economists. Leibenstein (1957) observed that, "if capital and labour, entrepreneurial facilities, technical knowledge, and credit facilities increase, the income per head will rise". Higgins (1959) marked, "credit may be necessary for expansion in some areas, especially small agriculture and small industry". Thus, among the various factors that govern the pace of agricultural development, credit has become one of them. Credit is assumed to be helpful for changing the composition and distribution of production in favour of deficit producers. Improved access to formal credit is supposed to shift rural borrowings from informal market to formal institutions, increasing the use of improved inputs and technology, leading to increased production and higher income for the rural poor (Donald, 1976).

## **METHODOLOGY**

The information collected in this paper is based on the secondary data by using internet, websites, magazines, books and journals gives a qualitative approach towards this research framework.

### **First Generation Banking Reforms and Agricultural Credit:**

In June 1991, the Government of India announced a new economic policy effecting major policy changes designed to correct the macro-economic imbalances and effect structural adjustment so as to bring about a more competitive system and promote efficiency in the real sectors of the economy. Financial sector reform is a necessary concomitant of trade and industrial policy liberalization and in fact is

critically important. Hence, in August 1991, the Ministry of Finance appointed Narasimham Committee on financial systems to examine all aspects relating to the structure, organization, functions and procedures of the financial system. The Committee submitted its Report in November 1991.

The Committee has observed that between 1969 and 1990, of the total increase of over 51,000 offices, as many as 33,600 were in the rural areas and over 7,900 in the semi-urban areas making for a total of over 80 per cent. Further, the increase in rural deposits as a proportion of the total increased from 3 per cent to 15 per cent. The advance to agriculture which stood at 5 per cent in 1969 has increased to 18 per cent of the aggregate credit as prescribed by RBI guidelines on priority sector lending. In purely quantitative terms this expansion must be regarded as a successful fulfillment of the objectives of the directed credit programme of RBI and government. Fixation of targets for specific sector lending was essentially the means to achieve the broader goals of credit allocation but over the years, the means appear to have become ends in themselves. The desire to attain credit targets has meant inadequate attention to 135 qualitative aspects of lending and a consequent rise in loan delinquencies. Over the years, competitive populism has affected banking and credit operations. The phenomenon of loan melas was quite contrary to the principles of professional appraisal of bank credit needs. There was hardly a serious appraisal of credit need potential, productive capacity or provision for effective post-credit supervision. Loan waivers have added an additional element of politicization of banking apart from the severe damage to the concept of credit discipline by encouraging defaults. Altogether, the proportion of the infected agricultural credit is estimated to be as high

as over 20 per cent. The Committee therefore proposed that directed credit programmes should cover are defined priority sector consisting of the small and marginal farmers also. The credit target for this redefined priority sector should be fixed at 10 per cent of the aggregate bank credit. For the credit flow to agriculture the Committee suggested the institution of a preferential refinance scheme by RBI as under:-

- I. A reorganization of the banking structure which would consist of i) three or four large banks (including SBI) which would become international in character. ii) eight to ten national banks with a network of branches throughout the country engaged in general or universal banking. iii) Local banks whose operations would be generally confined to a specific region, and iv) rural banks including RRBs whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing agriculture and allied activities.
- II. To abolish the branch licensing with a view that the banking system substantially extended its branch network over rural areas and successfully achieved an increase in banking density.
- III. To evolve a rural banking structure which could confine effectively the advantages of the local character of RRBs and the financial strength and organizational and managerial skills of the commercial banks. The committee suggested that the sponsor banks should segregate the operations of their rural branches through the formation of one or more subsidiaries depending on the size, administrative convenience and

business assessment of each sponsor bank. Each subsidiary should have a compact area of operations. These subsidiaries of the national banks should be treated at par with the RRBs in regard to the cash reserve and statutory liquidity requirements and refinance facilities from NABARD with a view to improving the viability of rural operations. Regarding the merger of RRBs with their sponsor banks, the committee left it to the option of the banks concerned.

### **Second Generation Banking Reforms and Agricultural Credit:**

In India since the formal announcement of the first initiative of financial sector reforms in the Union Budget of 1991-92 to the Second Report of the Narasimham Committee in 1998 a considerable ground has been covered in putting in place a financial system which can meet the requirements of a more competitive and open economy. In 1997, RBI set up a high level committee to suggest measures for improving the credit delivery system as well as simplifying the procedures for agricultural credit. The Committee submitted its Report on 21 April 1998. The Committee in its Report has made several suggestions to improve the flow of credit to the agricultural sector besides identifying the constraints faced by commercial banks in providing adequate and timely credit to the rural sector (RBI, 1997). A summary of the recommendations are listed below:

- i. All banks should examine their systems and make suitable modifications to simplify the documentation covering loan agreements.
- ii. While appraising credit proposals, attention should be paid to the evaluation of the income stream of

the borrower taking into account the track record of credibility, capacity as well as technical viability of the proposal. His repayment capacity should be assessed on the basis of aggregate household income and to ensure quick disbursal of loans at least 90 per cent of agricultural loan applications should be decided at the branch level.

- iii. Advocates the building up of an appropriate return-oriented liquid savings product into the loan to provide a cushion during lean periods.
- iv. The Committee advised that the system of disbursing agricultural loans partly in cash and partly in kind may be dispensed with.
- v. The Committees suggested for the setting up of dedicated recovery teams by the state government and also educate the borrowers through rurally oriented field publicity campaigns.
- vi. Recommended that RBI or any other agency may not prescribe margin, security, unit cost etc., which should be left to the discretion of the lending banker.
- vii. Proposed a substantial modification in the 'service area approach' that freedom should be given to the borrowers to choose any branch of a commercial bank for credit requirements and to banks to operate outside their 'service area'.
- viii. Further recommended to introduce annual composite cash credit limit for all agricultural borrowing families.
- ix. The Committee also advised to discontinue the practice of taking 'No Dues Certificate' from borrowers. It proposed designing specific loan products to meet the

demands of the borrowers in the non-farm sector i.e., increased non-farm activities with farm activities to supplement their income.

- x. The Committee pointed out that the agricultural credit portfolios of commercial banks comprise two sets of borrowers. One linked to government subsidy schemes where cases are sponsored by government agencies and sanctioned by banks and the other identified by banks directly. Recoveries in respect of the former are 30 per cent while in respect of the latter are 80 per cent plus. The Committee recommended a systematic review of the subsidy linked lending and favoured replacement by an alternative method of lending without subsidy and on the basis of commercial decision of banks.

The Advisory Committee on Flow of Credit to Agriculture and Related Activities from the Banking System (2004), under the chairmanship of Prof. Vijay Shankar Vyas recommended that RRBs should continue but they should be restructured into viable financial institutions, simultaneously retaining their regional character and rural focus. The alterations initiated in stages would ultimately result in 20 state-level RRBs. The Government of India, as part of its strategy to boost agriculture production, announced a package to double the flow of institutional credit to agriculture within three years starting 2004-05. Consequently, targets were set and the programme was implemented during the period 2004-05 to 2006-07. NABARD and RBI were vested with the responsibility of overseeing the implementation of the programme. There were notable inter-agency and an inter-district variation with regard to year of achievement of the doubling of agriculture

credit as well as in terms of 'number of times' the target was achieved. In all the states, the commercial banks fared better than the RRBs and Co-operatives. At all India level, institutional credit flow through the scheduled commercial banks increased from Rs.25,255.93 crores as by June end 2003 to Rs.1,15,265.86 crores by the end of June 2007, registering a compound annual growth rate (CAGR) at 47 per cent. During the same period, the number of accounts increased from 70.07 lakhs to 155.37 lakhs and registered an a CAGR of 22.15 per cent. Similarly, the average loan per account increased from Rs. 36040 to Rs. 74189 during the period 2003-07. Thus, the growth in credit flow between 2003 and 2007 resulted in both credits widening (increased accounts) as well as credit deepening (increased loan per account). At state level, credit widening and deepening varied substantially. The credit widening was more conspicuous in Maharashtra as the annual growth in number of accounts was 40 per cent and the average loan size increased at 10 per cent only. Madhya Pradesh followed similar trend. In the remaining three states (Tamil Nadu, Rajasthan and Uttar Pradesh), the growth in credit flow followed the all India trend and the contribution of widening and deepening to the credit flow was almost equal. In Uttar Pradesh and Rajasthan, the share of RRBs declined drastically while that of Co-operatives declined in all the states, except in Rajasthan. The Report has further suggested that there is a need to orient agriculture credit policies in a manner that is more conducive for the marginal and small farmers, tenant farmers, share croppers and oral lessees in accessing credit from formal institutions.

#### **Agricultural Credit Structure in India: Pre and Post Reform Periods**

Agriculture is the most important sector of the Indian economy from the

perspective of poverty alleviation and employment generation. Agriculture provides employment to around 60 percent of the total work force in the country. It Accounts for about 13 percent of India's national income at present.<sup>11</sup>The agriculture carried on customarily by poor, small and marginal farmers and weaker sections of the society, has faced the key problem of finance. Indian Government accentuated on directed credit programmes as an important policy which provided administered allocation of credit to priority sectors at concessional interest rates. The idea behind this policy was that, without government interference through directed credit programmes, banks funding could not be channelized to those activities which are of high social return or those categories of credit-worthy people who are marginalized in the credit market.

In India, the directed credit policies have been used for promoting agriculture and small-scale industry. Agriculture has been targeted because it is a risky activity and agricultural households are credit rationed by the formal sector (Swaminathan, 1991; Kochar, 1997). In addition, the availability of concessional credit augments the usage of quality inputs and encourages investment on machinery, irrigation and new technology to increase agricultural productivity. Thus, commercial and co-operative banks were directed to enlarge their rural branch networks and strengthen their lending to agriculture. Lending to priority sector became an important component of bank lending after the nationalization. With the increasing credit needs for farming operations, specific lending targets were fixed for each major bank and by March 1990, it was recommended to increase the proportion of direct agricultural lending to 18 percent of net bank credit. However, rural directed credit programme has not been a success,

especially in terms of allocation of resources, cost-effectiveness and access to credit to farmers. Various researches have established different reasons for the failure. Katula and Gulati, Rao, Binswanger and Khandker found that the agricultural lending rates set by the government were lower than commercial and industrial rates, and hence, commercial banks could not cover the cost of their agricultural loan from profit arising from other operations. This led to cross-subsidization of the agricultural operations (Katula and Gulati 1992; Rao 1994; Binswanger and Khandker 1995). Moreover, the objective to achieve quantitative targets, ignoring qualitative aspects and mounting overdues, created a threat to the viability of financial institutions. Further, the disbursal of loans without assessing the feasibility, capability and entrepreneurial experience of borrowers led the banks to incur losses due to the widespread problem of fungibility and poor repayment of the loan. Naastepad also concluded in his study that the effectiveness of directed credit programmes in stimulating investment, raising growth and reducing poverty was always a matter of dispute. One of the World Bank's study also supported that directed credit was inferior to a market-based allocation of resources in achieving growth and redistributive objectives (World Bank 1989; Odedokun1996). Therefore, the focus of India's financial reforms has been on the phasing-out of its directed credit programmes. Several Committees have been constituted to suggest ways to increase the availability of institutional credit to the rural areas.

These includes:

- ☐ The Expert Committee on Rural Credit (Chairperson: V.S. Vyas).
- ☐ Committee on Agricultural Credit through Commercial Banks (Chair

- person: R.V.Gupta)
- ☐ Committee on Co-operatives (Chairperson: Vikhepatil).
- ☐ Advisory Committee on Flow of Credit Agriculture (Chairperson: V.S.Vyas).
- ☐ Task Force on Revival of Co-operative Credit Institutions (Chairperson: A.Vidhyanadhan).

The government has accepted and implemented several of their suggestions.

The structure of agricultural credit system of India comprises government of India and Reserve Bank of India at apex and wide network of commercial banks, Co-operatives and Regional Rural Banks. Rural Co-operative Credit institution consist two tier long-term credit structure and three-tire short-term credit structure. Long-term credit structure consists at state level state co-operative agriculture and rural development bank and at village level, there are primary

co-operative agriculture and rural development banks. Short-term credit structure consists of state Co-operative Banks at state level, District Central Co-operative Banks at district level and Primary Agricultural Credit Societies at village level. Among the institutional sources, primary agricultural credit societies are the most important source of credit. Private moneylenders and agri-input dealers are also important sources of credit for the farmers. Non-institutional loans are obtained by farmers from commission agents, moneylenders, relatives and friends. Among these the commission agents and moneylenders are the dominating source of credit. On an average, commission agents and moneylenders provide more than 95 per cent of the non-institutional credit to agriculture. Interest charged by them is very high. The changing scenario of Indian Agricultural Credit in the course of three decades is presented in Table -1.

**Table-1**  
**Agricultural Credit Structure in India: Pre and Post Reform Periods**  
**(Percentages)**

<b>Credit Agencies</b>	<b>1971</b>	<b>1991</b>	<b>2011</b>	<b>2016</b>
Co-operative and Commercial Banks	24.4	58.8	52.8	46.3
Government and other Formal Sources	7.3	7.5	7.8	11.3
<b>All institutional agencies</b>	<b>31.7</b>	<b>66.3</b>	<b>60.6</b>	<b>57.6</b>
Professional and Agricultural moneylenders	36.1	17.5	18.2	10.8
Traders	8.4	2.2	4.8	0.1
Land lords	8.6	4.0	5.7	2.1*
Relatives and friends	13.1	4.6	4.4	22.7
Other sources	2.1	2.3	4.6	4.9
<b>All non-institutional agencies</b>	<b>68.3</b>	<b>30.6</b>	<b>37.7</b>	<b>40.6</b>
Sources not specified	0.0	3.1	1.7	1.8
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

**Source:** 1. All-India Rural Credit Survey 1971.  
 2.All India Debt and Investment Survey 1991.  
 3.Deveraja. T.S, “Rural Credit in India–An Over-view of History and Perspective”, Department of Commerce, University of Mysore, Hassan, India,

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4. NABARD Data bank (various issues) and ensure portal, NABARD 2016.

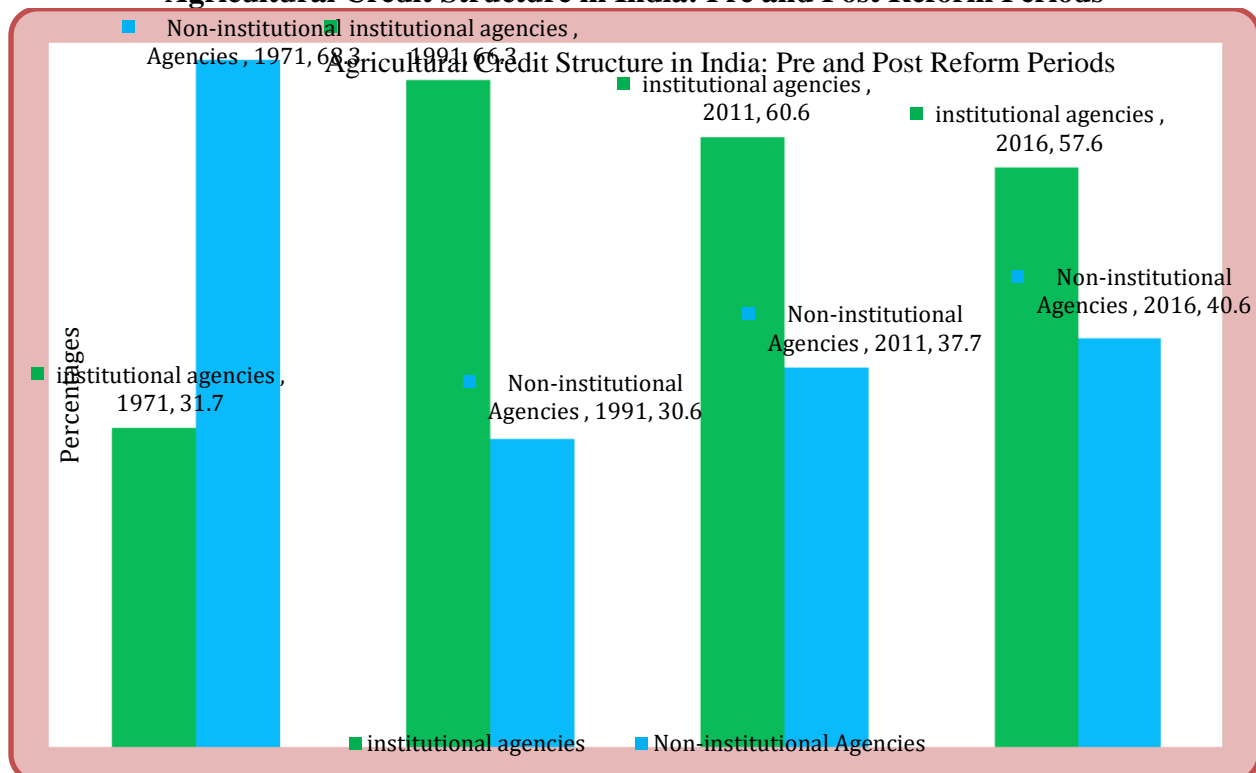
The table -1 informs us that during early green revolution period (1971) non-institutional credit agencies were leading with 68.3 per cent and institutional credit was 31.7 per cent. Where as in exact reforms period (1991) institutional credit agencies were emerged as 66.3 per cent and non-institutional credit agencies were 30.6 per cent. Here we have to congratulate the state contribution was significant. Furthermore, during 2011 year, again, non-institutional agencies had taken a little spike of 37.7 per

cent and institutional agencies were 60.6 per cent.

During 2016-17, the institutional Credit flow to the agriculture sector was to the tune of 57.6 per cent and Non-institutional agencies had increased when compared to the previous decade 2011 with the highest growth rate 40.6 per cent registered by the non-institutional agencies.

By all means, institutional credit agencies were took leadership role in financing farming community in India, which was a positive and healthy step towards farmer’s welfare in India. The agricultural credit structure is presented in figure-1

**Figure -1**  
**Agricultural Credit Structure in India: Pre and Post Reform Periods**





## FINDINGS

1. During early green revolution period (1971) non-institutional credit agencies were leading with 68.3 per cent and institutional credit was 31.7 per cent.
2. In exact reforms period (1991) institutional credit agencies were emerged as 66.3 per cent and non-institutional credit agencies were 30.6 per cent.
3. During 2011 year, again, non-institutional agencies had taken a little spike of 37.7 per cent and institutional agencies were 60.6 per cent.
4. During 2016-17 year, again non-institutional agencies had increased growth of 40.6 per cent and institutional agencies were 57.6 per cent.

## CONCLUSION

The governments at various levels along with the Reserve Bank of India and the NABARD have to implement the needed reforms further in the banking sector for expansion of institutional credit facilities to achieve inclusive agricultural growth in all the rest of the backward rural areas of the country.

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