



Agricultural credit in India: Issues and challenges

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Abstract

Agricultural sector occupies a key position in the Indian Economy. It provides employment to about 65 per cent of the working population in India. Nearly one-quarter of India's national income originates from the agriculture sector, It is imperative that the problems of farmers are addressed with a sense of urgency. Agriculture being State subject, the bulk of public investment in agriculture takes place at the level of states and the central government supports the States as a catalyst. Indian agriculture is one of the strong hold of the India economy and it accounts for 18.5 percent of the gross domestic product (GDP).

Capital requirement has increased manifold in agriculture due to increased use of purchased inputs like high yielding varieties (HYVS) of seeds, fertilizers, irrigation, pesticides and machineries in agricultural production process. Moreover, agricultural production process is biological in nature and has larger transition period, resulting in a wide time gap between investment and income. In order to produce more, the farmers need to spend more on modern inputs which must be financial either out of saving or through borrowing. Hence an increased institutional credit flow is essential for faster agricultural growth but the rural financing market development is a complex process because agriculture is small, widely dispersed, weather dependent, partially commercialized and deprived of basic socio-economic and institutional infrastructure. Moreover agriculture has got a preferred status for financing through institutional sources in India, particularly during post bank nationalization era. With this background, the present study concentrates on the issues of direct institutional credit for agriculture and allied activities in this post liberalized era.

Keywords: working population, capital requirement, institutional credit flow, commercial

1. Introduction

At the time of Independence in 1947, Indian Agriculture was traditional and stagnant in each and every respect. It was characterized by feudal nature, poor technology and low productivity. Modernization of agriculture was required both in terms of Institutional and technological changes. Abolition of intermediaries, like Jagirdars and Zamindars, was accomplished soon after independence. The largest portion of the natural resources of India consists of land and by far the largest number of its inhabitants is engaged in agriculture. A large proportion of population, about three fourths, depends on agriculture which is a subsistence occupation.

Agricultural sector occupies a key position in the Indian Economy. It provides employment to about 65 per cent of the working population in India. Nearly one-quarter of India's national income originates from the agriculture sector, It is imperative that the problems of farmers are addressed with a sense of urgency. Agriculture being State subject, the bulk of public investment in agriculture takes place at the level of states and the central government supports the States as a catalyst. Indian agriculture is one of the strong hold of the India economy and it accounts for 18.5 percent of the gross domestic product (GDP). Agriculture draws its significance from the fact that it has vital supply and demand links with the manufacturing sector and is a source of livelihood for the rural population of India, and it represents the backbone of rural livelihood security system. There's more loan money in the farmers hands now than ever before. It is one of those rare

cases of money well lent, since the rate of recovery from direct agricultural advance made by the public sector banks has been steadily moving upward.

One of the areas of concern is the discussion on new economic policy since from 1991 has been our agricultural sector. So far the reform package in our economic polices has not explicitly touched upon the agricultural sector, except, marginally, and the policy document for the agricultural sector reforms is yet to be ready. But the majority of our working population is still engaged in agricultural and allied activities, and the growth performance of the economy also crucially depend on the scale a well as the rate of growth of agricultural production. Although we now have enough buffer stock of food grains to stave off sudden crop failures, and the country has experienced good monsoons for the last eight successive years, there are some disturbing trends in the agricultural sector. First of all, public investment as well as private investment in agriculture in real terms is declining. Secondly, in view of the post GATT accord scenario, the major advanced countries in Europe and America shall have drastically reduced non-tariff barriers against export of primary products from the developing countries. There are large scope for over agricultural output and exports to expand, and this requires large scale investments in infrastructure in rural areas so as to enhance productivity growth to match increased demand and make agricultural exports competitive. Thirdly, the politics of procurement prices and fertilizer subsidies in our country, which discriminates against small

and marginal farmers may compel them to switch towards non-food crops at least temporarily, thus creating wage gap in the economy. Finally, many of the world rural development programs whose basic thrusts have been poverty alleviation and employment generation, indirectly benefit agricultural growth across different regions of India, and in the absence of a co-ordinated policies the desired effects of these schemes may prove to be elusive for the agrarian economy in general, and rural assets creation in particular.

The economic environment in the post GATT accord scenario for the Indian economy is inherently complex and warrant careful planning with respect to monitoring of expectations and incentives and tinkering with the terms of trade and associated issues appear important both for short and the long run considerations of growth, distribution and international competitiveness of agricultural sector. It should be emphasized that a healthy agrarian economy is a sine qua non for rapid industrial growth as well and any set back in the production process. Farmer will also have deleterious consequences for the rest of the economy, making the tasks of our policy reformers much more difficult in the coming days than are being conceived at present.

2. Statement of the Problem

We should have banking for the poor, not poor banking in crucial areas. Capital requirement has increased manifold in agriculture due to increased use of purchased inputs like high yielding varieties (HYVS) of seeds, fertilizers, irrigation, pesticides and machineries in agricultural production process. Moreover, agricultural production process is biological in nature and has larger transition period, resulting in a wide time gap between investment and income. Although the farmers prefer to hold their savings to invest in physical productive assets on their own farms, they also rely on credit. In order to produce more, the farmers need to spend more on modern inputs which must be financial either out of saving or through borrowing. Hence an increased institutional credit flow is essential for faster agricultural growth but the rural financing market development is a complex process because agriculture is small, widely dispersed, weather dependent, partially commercialized and deprived of basic socio-economic and institutional infrastructure. Moreover agriculture has got a preferred status for financing through institutional sources in India, particularly during post bank nationalization era. Hence, the study on agriculture credit is more essential from multi angles.

3. Review of literature

With the starting of the process of liberalization and globalization of Indian economy in 1991 a good number of studies covering these aspects have been published. The economic reforms process has been concerned mainly with the industrial, fiscal, financial and external sectors.

Desai and Mellor (1993) studied the institutional credit flow in India. They find that increased institutional credit flow is essential for faster agricultural growth. But the rural financing market development is a complex process because agriculture is small, widely dispersed, weather dependent, partially commercialized and deprived of socio economic and institutional infrastructure.

An overview of the performance of Indian agricultural economy during the last fifty years was studied by Sankaran and G. Mythili (2001). It is a very broad based study and covers all the major aspects of Indian agriculture they observed deceleration in growth rates of production of food grains in the ninety's and fast increase in the output of horticultural crops, livestock and fisheries. They also find a high correlation between agricultural growth and gross domestic product growth. There exists a good potential for increasing the average yield per acre and diversification of agricultural economy.

S. R Kulshresta (2013) studies the performance of commercial banks in delivering agricultural credit. He made clear that in order to meet the growing demand for production and investment credit for agriculture and rural development activities the commercial banks and Regional rural Banks have expanded their geographical coverage, particularly in rural areas, in a big way during the last decade or so.

4. Objectives of the study

1. To study institutional financing for the agricultural sector in India.
2. To examine the relationship between economic reforms and institutional finance for the agriculture development of the Country.
3. To analyze the gap between demand for and supply of agricultural credit for promoting agricultural development in India.

5. Methodology

The study is based on the secondary data. The secondary data was used for analyzing the trends in institutional finance. The data was collected from various reports published by the government at different level. RBI Publications, reports of the Economic Survey and other reports are used to collect and to analyse the Data. Simple statistical techniques were used to have findings and to draw conclusions.

6. Analysis and Discussion

6.1 Overview of the agricultural Credit in India

The Government of India and the Reserve Bank of India (RBI) issued specific directives regarding "social and development banking" from time to time. These policies included the setting of targets for the expansion of rural branches, imposing ceiling on interest rates, and setting guidelines for the sectoral allocation of credit. During the early part of bank nationalization, the National Credit Council under the chairmanship of D.R. Gadgil had considered the deficiencies in the system of institutional credit and formulated the lending policies for the future. Specific lending targets were fixed for different sectors in terms of amounts to each major bank. In this context, two major steps were taken by the RBI to encourage the priority sector lending such as provision of refinance to commercial banks, and introduction of credit guarantee scheme as a support measure of bank lending. With the establishment of Regional Rural Banks in 1975, another wing to the agricultural credit was added. RRBs were designed to be low cost institutions like co-operatives and professionalized in their management like commercial banks. Their target group was the 'weaker

sections' consisting of small and marginal farmers, agricultural labourers and rural artisans, and their area of operation was confined to specified districts.

The Committee to Review Arrangement for Institutional Credit for Agricultural and Rural Development (CRAFICARD), 1981, endorsed that commercial banks could play a significant role in the various programmers of rural development, and suggested measures to improve the quality of lending through these banks. The National Bank for Agricultural and Rural Development (NABARD) was, therefore, set up in July 1st 1982 by the RBI for providing all types of production and investment credit for agriculture and rural development. NABARD is the apex institution accredited with all matters concerning policy, planning and operations in the field of agriculture and other economic activities in rural areas. Its prime role is to provide credit for the promotion of agriculture, small-scale industries, cottage and village industries, handicrafts and others rural crafts and allied economic activities in rural areas with a view to promoting interacted rural development and securing prosperity for the rural areas. Other functions include co-ordination of rural financing activities of all institutional works at the field level and maintaining liaison with the Government of India, State Government, RBI and other national level institutions.

Preoccupation to achieve quantitative targets, ignoring qualitative aspects, high cost structure of operations in rural areas, and mounting over dues, became threat to the viability of financial institutions. Consequently, the policy of competitive financial system was adopted in provisioning agricultural credit to improve the viability of financial agencies. This phase of policy started from 1991, particularly after liberalization. The policy thrust of this phase can be found in the report of the Committee on the Financial System (CFS) chaired by M.Narasimham. In its very first paragraph, the report calls for a vibrant and competitive financial system to sustain the ongoing reform in the structural aspects of the economy. The committee suggests the use of fiscal instrument for redistributive objective rather than the credit system. Based on this, the committee recommends that directed credit programmers' be phased out. The proposals of the committee were deregulation of interest rates, changing capital adequacy norms (to compete with banks globally), and removing branch licensing policy. Besides, the committee took the view that a new institutional structure, i.e., market driven and based on profitability be created, and that the role played by private Indian and foreign banks need to be enlarged. In short, the Narasimham Committee recommended that banking policy be guided more by the market force than by regulations of public authority.

Rationalization of interest rate (rate to the ultimate borrowers) is the other important aspect of policy changes in the reform phase. the process of rationalization of the interest rate for rural credit, in general, and agricultural credit, in particular, was initiated by the RBI in September 1990 based on the recommendations of the Narasimham committee deregulation

of interest rates and abolition of concessional lending rates so that all rates became positive in real terms.

6.2 Progress in Agricultural Credit in India

Agricultural credit clearly started to grow after bank nationalization, and it has been growing continuously since then. With all the concerns and skepticism expressed, the difficult and continuous changes in institutional credit have indeed borne fruit. Over the years there has been a significant increase in the access of rural cultivators to institutional credit and, simultaneously, the role of informal agencies, including money lenders, as source of credit has declined. The existing agricultural credit system is geared to the needs of food grains production: with the share of food grains production falling as a proportion of total agricultural production, it is all the more creditable that agriculture credit has not fallen. The age old problem of rural credit has been the excessive reliance of borrowers on money lenders and other informal sources that have entailed usurious interest rates and exploitation. It is quite remarkable how long it has taken to really substitute institutional credit for informal money lending channels and how tortuous the process of change has been taken place over the 50 years from the beginning of serious attention in the 1930s to the 1980s. It was the nationalization of banks in 1969 and subsequent spread of rural bank in 1969 and subsequent spread of rural bank branches that has really made a difference in reducing, finally the share of money lenders in agricultural credit. It has taken drastic action ranging from the formation of cooperatives to bank nationalization, setting up of RRBs and the like. The Indian record of extension of rural credit is quite a story of institutional innovation.

The remarkable feature of agricultural credit extension in India is the widespread network of Rural Financial Institutions (RFIs). Following the first phase of nationalization of commercial banks in 1969, large scale branch expansion was undertaken with a view to creating strong institutional base in rural areas. At the time of nationalization in June 1969, the total number of rural offices of Scheduled Commercial Banks (SCBs) was 1,833, which then increased significantly to 32,406 by March 2003. The number of co-operative institutions catering to agriculture went up from 95,871 in end-June 1980 to over 1,50,000 at present. The share of the rural branches of scheduled commercial banks (including RRBs) in total increased sharply from 22 per cent in June 1969 to 47 per cent by March 2003. The main story in the expansion of rural credit in the 1980s and 1990s has been the ascendancy of commercial banks, along with RRBs, with a corresponding fall in the share of cooperatives. This is reflected in the increasing concern in recent years over the effectiveness, governance and financial health of rural cooperative banks. Just under half of rural credit continues to be extended by them and hence it is essential that they be revitalized and put on a sound business footing. There has been increasing expression of concern on the extension of agricultural credit after 1990s.

Table 1: Direct Institutional Credit for Agriculture and Allied Activities –Total (Short-Term and Long-Term)

Year	Loans Issued						Total
	Co-operatives	% share in Total	SCBs	% share in Total	RRBs	% share in Total	
1	2	3	4	5	6	7	8
2001-02	305.69	56.9	186.38	34.7	45.46	8.46	537.52
2002-03	340.40	52.2	252.56	38.8	58.79	9.02	651.75
2003-04	400.49	48.0	362.03	43.4	71.75	8.6	834.27
2004-05	450.09	42.7	483.67	45.9	119.27	11.3	1053.03
2005-06	481.23	33.4	805.99	56.0	153.00	10.6	1440.21
2006-07	540.19	28.5	1152.66	60.8	202.28	10.7	1895.13
2007-08	576.43	29.6	1134.72	58.2	238.38	12.2	1949.53
2008-09	587.87	23.9	1606.90	65.3	264.99	10.8	2459.76
2009-10	634.97	22.2	1882.53	65.7	346.40	12.1	2863.90
2010-11	781.21	22.7	2227.92	64.6	439.65	12.7	3448.78
2011-12	879.63	19.4	3128.77	68.9	530.58	11.7	4538.98
2012-13	1112.03	16.8	4844.99	73.4	646.49	9.79	6603.51
2013-14	1199.64	17.0	5090.00	72.0	783.74	11.1	7073.38
2014-15	1385.00	16.5	6044.00	71.9	978.37	11.6	8407.37
2015-16	1533.00	17.5	6047.00	69.0	1187.96	13.5	8767.96
Total	11207.87	-	35250.12	-	6067.10	-	52525.09
CAGR	11.8		29.2		25.7		22.9

Notes: 1. SCBs: Scheduled Commercial Banks. RRBs: Regional Rural Banks.

2. CAGR: Compound Annual Growth Rate

Sources: 3. Reserve Bank of India (RBI) Bulletin

4. National Bank for Agriculture and Rural Development (NABARD)

5. Handbook of Statistics on Indian Economy: 2015-16

The Table -1 shows that direct institutional credit for Agriculture and Allied activities both short term and long term. The total lending to the agricultural sector has raised from 537.5 Billion rupees in the year 2001-02 to 8767.9 Billion rupees in the year 2015-16 and witnessed for Compound Annual Growth Rate (CAGR) of 22.9 per cent. In the beginning years of the study period i.e., 2001-02 the share of Co operatives in total credit was 60 per cent, whereas it has been declined to 17.5 per cent in 2015-16. But the credit lending has raised from 305.6 Billion to 1533 Billion rupees.

The Compound Annual Growth Rate of Credit flow by Co operatives is 11.8 per cent.

Over the period of 15 years, the share of Scheduled Commercial Banks (SCBs) has increased continuously from 34.7 percent in the total credit in 2001-02 to as large as 69.0 per cent in the year 2015-16 and accounted for Compound Annual Growth rate of 29.2 per cent. Regional Rural Banks (RRBs) also registered for the CAGR of 25.7 per cent. One could see considerable growth in Agricultural Credit flow from Co, SCB and RRBs.

Table 2: Agricultural Credit Flow as Per cent of GDP (at current prices) (In Billion)

Year	Credit flow	GDP	% share of GDP
2001-02	537.52	23483.30	2.3
2002-03	651.75	25306.63	2.6
2003-04	834.27	28379.00	2.9
2004-05	1053.03	32422.09	3.2
2005-06	1440.21	36933.69	3.9
2006-07	1895.13	42947.06	4.4
2007-08	1949.53	49870.90	3.9
2008-09	2459.76	56300.63	4.4
2009-10	2863.9	64778.28	4.4
2010-11	3448.78	77841.16	4.4
2011-12	4538.98	90097.22	5.0
2012-13	6603.51	99513.44	6.6
2013-14	7073.38	112727.64	6.3
2014-15	8407.37	124882.05	6.7
2015-16	8767.96	135760.86	6.5

Source: 1. Reserve Bank of India (RBI) Bulletin

2. Handbook of Statistics on Indian Economy: 2015-16

3. Indian Economic Survey of different years

Table-2 clearly states that Agricultural Credit flow as per cent of Gross Domestic Product (GDP) has raised gradually in the study period i.e., 15 years from 2001-02 to 2015-16. The

Compound Annual Growth Rate was 2.3 per cent in 2001-02 and it was 6.5 per cent in 2015-16. It is very clear that the credit flow as per cent of GDP has been increased

continuously. It shows the concentration put forward by the different levels of Government and other Institutes.

6. Conclusion

In the liberalized era institutional credit is indeed reaching a substantial proportion of farmers. With the share of agricultural GDP falling in total GDP, it is to be expected that the share of agricultural credit will go down as a proportion of total credit. But we do need to ensure that it does not fall as a share of agricultural GDP, and that it in fact intensifies and it has upward trend in the recent past. What is needed is a better analysis by banks on where the risks are in the extension of agricultural credit, and to then find market-oriented solutions for mitigating such risks. Where the mitigation of such risk involves positive externalities and the promotion of public good, methods of appropriate government intervention would need to be identified and considered. There is an urgent need for the adoption of the best modern techniques for risk management in agriculture, including a clearer distribution between risky and less risky borrowers. Banks need to adopt a more specialized approach as between different agricultural sectors and regions in order to achieve a better understanding of agricultural credit needs and risks on a disaggregated basis. There is an increasing need for allied activities and term lending, and hence a change in our traditional view of what constitutes agriculture and how it should be promoted.

7. References

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