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Credit Policy for Agriculture in India - An Evaluation

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Abstract: Rural indebtedness and dependence on private moneylenders is an age-old problem in India. For more than 100 years now, the Central Government and the Reserve Bank of India have been making efforts to enhance institutional credit in rural areas particularly to assist in agricultural operations. It began with the enactment of the Co-operative Credit Societies Act (1904) but efforts were redoubled after the nationalization of Scheduled Commercial Banks in 1969. The aim of this paper is to evaluate the measures taken over the years and assess the extent to which they have been successful. It attempts to answer the question, "Is the agenda of expansion of institutional finance to agriculture unfinished?" The findings in the paper are inconclusive on this issue on account of contradictions in evidence: while the 2013 AIDIS survey finds that no institutional lenders still account for only 36 per cent of the total outstanding agricultural loan, the short-term credit from institutional sources in 2012-13 covered 100 per cent of the input cost in agriculture in that year according to the National Accounts Statistics. This research paper indicates the Credit Policy for Agriculture in India.
Keywords: credit policy, commercial banking, Interest Rates, Institutional Credit, Distribution.

Introduction: Rural indebtedness is an age-old problem in India. In the nineteenth century, commercial banking was non-existent in rural areas, and farmers were completely in the hands of usurious moneylenders. Starting from the days of British rule, the central government has been striving to expand institutional lending to the rural agricultural sector. In recent decades, efforts in this direction have intensified and today, there is a vast network of institutions providing credit for agriculture.

One of the first steps taken by the Government of India towards addressing the problem was the establishment of co-operative credit societies. The Co-operative Credit Societies Act (1904) was passed to provide cheap and cost-effective financial services to farmers and attempts were made thereafter to widen the co-operative movement. The Maclagan Committee (1915) and the Royal Commission of Agriculture in India (1928) focused on the expansion of co-operatives in the country. The RBI Act, 1934, made provisions to establish an Agriculture Credit Department in the bank and extend refinancing facilities to the co-operative credit system.

However, there was a slowdown in the co-operative movement in subsequent years, as a large number of co-operative institutions were found to be saddled with the problem of frozen assets, because of heavy overdoes in repayment. The RBI commissioned the All India Rural Credit Survey in 1951 to understand the situation at the grassroots level and address concerns regarding the financing of the rural sector. The committee recommended the creation of an efficient system of agricultural finance and the development of a sound co-operative credit structure. They suggested increasing the share of co-operatives and advised that at least one member of each household should be a member of a co-operative institution.

A directed credit programme towards certain priority sectors was a major development policy in both developed and developing countries in the 1960s. The shortfall in agricultural output in India in 1966 and 1967 helped focus attention on the need for commercial banks to increase their involvement in financing agricultural activities. Under the concept of priority sector lending introduced in 1972, commercial banks were mandated to advance a certain proportion of their funds to these priority sectors, which included agriculture and small-scale industries.

The Narasimham Committee on rural credit (1975) recommended the establishment of Regional Rural Banks, as it was of the view that neither commercial banks nor co-operative institutions were able to meet agricultural credit needs. Another major step taken towards the development of rural credit was the establishment of NABARD in 1982 by a special act of Parliament on the recommendation of the Committee to Review Arrangement for Institutional Credit for Agriculture and Rural Development. Its mission is to "promote sustainable and equitable agriculture and rural prosperity through effective credit support, related services, institution development and other innovative initiatives" (NABARD).

In 2006-07, the central government introduced an interest subvention of two per cent for short-term credit up to Rs.3 lakh. The subvention was enhanced subsequently and by 2013-14, an additional subvention of three per cent was available for prompt payment, making a total subvention of five per cent and reducing the effective rate of interest for short-term credit to four per cent.

Expansion of institutional credit: Since the most important objective of government in agricultural credit after independence has been to strive for a greater share of institutional credit, we begin our analysis by looking at the evolution of institutional/non-institutional shares in rural and agricultural credit since 1951. The share of non-institutional credit as a proportion of overall rural credit declined rapidly during the period 1951-81, and more slowly in the next decade but the trend seems to have reversed during the period 1991 to 2002. The overall trend in agricultural credit is broadly similar but there is some variation after 2002 Unlike in rural credit, it is seen that the institutional share in agricultural credit gained some ground in 2013, although it still remained lower than in 1991. With a number of policy measures taken by the government to step up the supply of agricultural credit in the decade of the 2000s, which we shall review later, it was expected that there would be an increase in the share of institutional credit. However, the latest report of AIDIS (2013), 70th round, has belied these expectations and it is seen that the share of institutional credit lost ground in agriculture and fell from 66.3 per cent in 1991 to 64 per cent in 2013.

Interest Rates Charged by Institutional and Non-Institutional Sources: Non-institutional sources have shown resilience in retaining a large share of the outstanding debt despite the fact that the rates of interest charged by them are generally much higher than those charged by institutional sources. According to the latest AIDIS Survey, as much as 71 per cent of the outstanding dues from non-institutional sources attracted interest rates of more than 15 per cent in 2013 whereas the corresponding figure for institutional sources was only 10 per cent. Further, outstanding debt at rates above 30 per cent was as much as 34 one per cent for non-institutional sources and only one per cent for non-institutional sources. It is, however, significant that non-institutional agencies also grant loans at zero per cent rate of interest and the share of interest-free debt in the outstanding debt was almost 18 per cent and18.3 per cent in 2002 and 2013, respectively. The flexibility to offer interest-free loans helps no institutional agencies to lure their rural clients.

Trends in Institutional Credit: Direct lending to farmers by institutional agencies (co-operative banks, commercial banks and regional rural banks) takes the form of either short-term or long-term credit. In addition, there is substantial lending for allied activities, which is deemed to constitute indirect financing of agriculture.

Short-term agricultural credit or crop loans enable cultivators to procure inputs such as fertilizer and seeds needed for seasonal agricultural operations, while long-term credit is for investment in fixed assets, such as irrigation pumps, tractors, agricultural machinery, plantations and those related to dairying, fishing and poultry. Short-term credit is also meant to cover the cost of hired labor as well as a part of the consumption needs of poorer farmers. Indirect finance of agriculture includes loans to input dealers, loans for setting up agri-clinics and agribusiness centers, loans to microfinance institutions, loans to dealers in agricultural machinery and drip and sprinkler irrigation systems, loans for construction and running of cold storage units, irrespective of their location, loans to food and agro-processing units, and diverse other activities related to agriculture.

Factors contributing to the growth of agricultural credit:-

- Growth of rural branches of commercial banks.
- Establishment of Regional Rural Banks (RRBs).
- Priority Sector Lending.
- Self-Help Groups (SHG)-Bank linkage Programme.
- Special Agriculture Credit Plan.
- 2004 Initiative for Doubling of Agricultural Credit.
- Kisan Credit Cards.
- Financial Inclusion Programmes.

Performance of Institutional Credit Agencies: In the year 1975-76, co-operative banks accounted for the largest share of 75 per cent, followed by commercial banks at 25 per cent and RRBs at 0.13 per cent. In 1990-91, the shares of cooperative institutions and commercial banks were almost equal at 48 per cent and 49 per cent, respectively. Thereafter, there has been a turnaround in the position of these two institutions. There is a gradual decline in the share of co-operatives and an increase in the share of commercial banks. By 2012-13, the share of co-operative banks had fallen to around 17 per cent while that of commercial banks had increased to 73 per cent. The share of RRBs increased to 9.79 per cent in 2012-13 as compared to 3.4 per cent in 1990-91.

Trends in Long-Term and Short-Term Credit: Based on tenure, agriculture credit can be classified into long-term and short-term credit. Short-term credit is typically for six months but covers credit up to one year. Long-term credit includes the medium term.

The amounts advanced as long-term and short-term credit have both been increasing rapidly. While long-term credit grew from Rs.500 to Rs.1, 07,162 crore, short-term credit expanded from Rs.1,096 to Rs.3,46,737 crore during the period from 1975-76 to 2011-12. The rate of growth of short-term credit was a tad higher, and the share of short-term credit increased from 68.7 in 1975-76 to 76.4 per cent in 2011-12.

Distribution of benefits of Agriculture Credit by Commercial Banks: The criticism of elite capture of the benefits from agricultural credit is supported by an analysis of the distribution of total agriculture advances by size class limits between 1990 and 2011. Ramakumar and Chavan (2014) point out that there is a sharp decline in the share of loans less than Rs. 2 lakh in total advances, from 58.7 per cent in 1990 to just 5.8 per cent in 2011. On the other hand, the share of loans above Rs.25 crore increased from 5.7 per cent in 2000 to 17.7 per cent in 2011. However, the picture is more complex than the analysis above suggests. We find that there has been an increase in disbursement across all three categories of size-holdings (up to 2.5 ha, between 2.5 and 5 ha and above 5 ha), whether we consider the total amount disbursed (Figure 9), the number of accounts or the amount disbursed per account. The increases for the smallest category are at least on par with increases in other categories.

Credit Subsidy in Indian Agriculture: Before the introduction of economic reforms in 1991, the banking sector in India was comprehensively regulated, and one aspect of this was that an administered regime applied to interest rates with the Reserve Bank of India stipulating the minimum and maximum rates of loans and applying restrictions on deposit rates as well. Lower rates of interest were charged on loans to agriculture and other priority sectors and the stipulated minimum did not apply to them. These lower interest rates were made possible through cross-subsidies, not involving a direct contribution from the government. The 1991 economic reforms changed all that and bank interest rates were virtually deregulated, both on lending and deposits. By 1995, cross subsidization of credit for agriculture (and other priority sectors) had been terminated. However, the food crisis of 2006-07 saw the government taking a number of initiatives and one of them was the grant of subvention to enable lending institutions to advance credit to agriculture at a lower rate of interest.

Evaluation of Subsidy on Short-term Credit: The scale of expenditure on credit subsidies in agriculture may not be comparable to that on other input subsidies, such as fertilizer, power and irrigation. However, credit subsidies also have an incremental effect on the mounting fiscal burden and we need to analyze and evaluate the benefits of these subsidies.

To what extent does the credit subsidy reduce the cost of working capital for the farmer and increase the profitability or income of the farmer? Table 8 gives data on working capital as a percentage of the cost of cultivation for nine major crops for six recent years. It is seen that, except in the case of cotton (in which the percentage is about 3 per cent), interest on working capital constitutes between 1 and 2 per cent of the cost of cultivation.

Agricultural Debt Waiver: In addition to subvention on short-term credit introduced in 2006-07, there has been an intensification in the use of the instrument of debt waivers, which results not only in a waste of financial resources but also has adverse consequences for the banking system and seriously impairs its ability to deliver agricultural credit on a regular basis.

The first waiver decision was taken in India in 1990 and the Agriculture and Rural Debt Relief Scheme (ARDRS) was approved. The announcement was made when the country was preparing for general elections, and the ostensible objective was to provide relief to the farming community overburdened with debt. The following years witnessed a decline in the recovery rates by financial institutions, as farmers believed that they could default with impunity. It affected rural credit with defaults of such a high magnitude that it took the banks several years to recover from its impact (Report on Task Force of Rural Co-operative Credit Institutions, 2006). Although the scheme was implemented during 1990-91, the real impact may have been felt from November 1989 itself when various political parties started making promises that they would write off agricultural loans if they returned to power. A study (Shylendra & Singh 1994) has found concrete evidence that the loan recovery of PACS in Karnataka fell from 74.9 per cent in 1987-88 to 41.1 per cent in 1991-92.

Conclusions:

Institutional vs. non-institutional credit: Even though there has been an impressive growth in institutional credit since 1951, the dependence of farmers on non-institutional sources for agricultural credit remains as high as 36 per cent in 2013. There was a steep fall in the share of non-institutional sources in the total outstanding agricultural credit from 89.8 per cent in 1951 to 33.7 per cent in 1991. However, in the next decade, non-institutional sources wrested back some of their lost share, which stood at 38.9 in 2002. In 2013, there was a small decline in their share of outstanding loans but, at 36 per cent, it was still above the 1991 level. What is striking is that there is a rising trend in the share of private moneylenders from 17.2 per cent in 1981, 17.5 per cent in 1991, 26.8 per cent in 2002 and 29.6 per cent in 2013.

Dominant Role of Commercial Banks: Notwithstanding the AIDIS finding on the evolution of shares of institutional and non-institutional sources in total outstanding, there has been a striking increase in credit flows from institutional sources in recent decades.

Rise in short-term credit from institutional sources and coverage of input costs: Short-term credit is provided primarily to finance the purchase of inputs. During the 1970s, 1980s and 1990s, the aggregate short-term credit as a proportion of input costs in agriculture was in the range of 13-20 per cent. However, since then, the increase in short-term credit has been much larger than the input cost, so much so that in 2012-13, it was as much as 99.97 per cent of the input cost, including compensation to hired labor.

Scope for further expansion of institutional finance: What are the implications of the foregoing findings in terms of answering to the question that we asked at the outset? Is the agenda of expansion of institutional finance for agricultural credit unfinished? AIDIS 2013 would seem to indicate so.

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