

Rural Credit Delivery in India: Structural Constraints;



Commerce

KEYWORDS :

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In the post-economic reforms era, Indian! Agriculture has been subjected to various external! And domestic forces that have compelled the farmers! To change their product-mix as well as organization! Of the farming. Distress has set in the rural economy in many areas, even forcing farmers to commit suicides as an extreme reaction. The major changes that have directly impacted the agricultural sector are financial sector reforms, decontrolling of fertilizer prices, freeing of imports of agricultural commodities, etc., Of these, the financial sector reforms have been crucial in view of its influence on rural credit delivery. The rural credit plays a very crucial role in agriculture and rural economy. And, any disturbance in its delivery mechanism can cause cascading effects. Demand for credit emanates from demand for inputs and services needed for various farm operations. It constitutes a major portion of liquidity with farmers and imparts the needed purchasing power to the capital starved farmers.

Public policy in the country has always been directed towards ensuring adequate and cheaper and adopts institutionalization of credit as the primary focus. Significant progress has been made in institutionalization of rural credit and the credit supply from formal agencies to agriculture has grown year after year, several gaps in the performance notwithstanding.

Today, the rural credit situation looks grim in spite of many measures and constitution of several committees and task forces. It has been a constant target of policy coarctation, especially after 1991 which manifested in three broad areas, viz. enervation of the institutional architecture for rural credit, disincentivisation of credit flow to agriculture through the mechanical application of Basel norms, and squeeze on resources available for agricultural credit operations (Satish, 2007).

In this context, this paper has charted out recent developments in the evolution of rural credit system, highlighting a few structural constraints. The paper has first discussed a few structural problems in the rural credit system that hampered the credit delivery and has then described measures taken to improve it.

Rural Credit System — Existing Structure

In India, we have adopted multi-agency approach to rural credit. From the initial steps to provide Takkavi loans by the Government, cooperatives emerged as the first institutional arrangement to provide loans to farmers. Though Cooperative Act came in 1904, till 1950s the progress in terms of outreach by cooperatives was limited. This led to the Nationalization of Commercial Banks in 1969 and again in 1980, to step up credit supply to the rural people. Then, came Regional Rural Banks (RRBs) in mid-1970s. Thus, the credit architecture consisted basically of cooperatives, commercial banks and regional rural banks. In terms of agency-wise share in rural credit, the progress of institutionalization was impressive. The share of institutional agencies in the borrowings of cultivator households increased from mere 7.3 per cent in 1951 to 66.3 per cent in 1991. During 1990s, the share of non-institutional agencies increased to reach 38.9 per cent in 2002. This may be due to increased role of dealers of various inputs in financing cultivators, diminished interest of commercial banks in rural finance after Financial Sector Reforms of 1991, deterioration of health of cooperative system, among others. Ironically, the states with higher degree of commercializa-

tion had higher share of non-institutional sources (Staysail and Viswanathan, 2003).

Structural Constraints to Credit Delivery Ineffective Multi-Agency Approach;

The multi-agency system was envisaged to cater to the diverse credit needs and benefit the rural people by giving a wide choice of the agencies to avail credit. But in reality, the rural clientele hardly j enjoyed the benefits of the approach as the system.; suffered from deficiencies in design and architecture, Though multiple agencies existed in the market, they ' offered different products and to different target groups. Cooperatives have two separate channels for j purveying short-term and long-term loans and never] showed any coordination between the two channels, 1 putting their members at a disadvantage. RRBs I served lower segments of the society which are not I generally covered by the cooperatives and! Commercial banks. Due to security norms and other I procedural rigidities, hardly any scope was there for farmers to choose any other agency once they entered into contract with any one of the agencies. Besides, deterioration of health of the constituents, waning j of their interest in rural lending and short-sighted j policies led to dysfunctioning of the system. In what follows, we highlight a few key problems in the constituent agencies in the rural credit system that reduced the effectiveness of the system.

Cooperative System in Muddle

A serious drag on the multi-agency approach is the ineffective cooperative system. Poor health, lack of adaptation to the needs, politicization, loss of member orientation and credibility inter alia disoriented the system. Table 2 gives the health of the cooperative system in the country. It can be easily seen from the table that cooperative system is incapacitated due to heavy losses which invariably increased over the past few years. Cooperatives are ailing in most of the districts and lost their eligibility for NABARD's refinance. This impaired their ability to lend fresh loans and hence, their borrowers lose their freedom to choose the agency or product.

Cooperative system displayed inherent rigidity and did not change with times. It grew bigger in size over time. But, it did not adopt the technology and professionalism needed to manage the structure. Nor it resorted to the restructuring needed. Integration of short-term and long-term structures of cooperatives was mooted by Hazari Committee way back in 1976 as a measure to impart cost economies besides offering all the services through a single window. Except Andhra Pradesh, where integration was done in mid-1980s, no other state pursued this seriously, in spite the positive feed back from Andhra Pradesh experience Ramireddy, 1996; Satyasai and Viswanathan, 1995. Another measure recommended

Backtracked RRBs

RRBs were designed to combine local feel and low cost of the cooperatives and professionalism of commercial banks. Somewhere the hybridization process went wrong and what emerged finally was the high cost structure and culture of commercial banks. Due to the restrictions on their client base and the cap on the rate of interest they can charge on their loans, many of them incurred heavy losses. Capital was infused and RRBs were allowed to lend to non-target population and as

of now RRBs can lend to anyone without any restriction and are almost on par with any other commercial bank in business scope.

The performance of RRBs had not been very impressive all along. One reason often quoted is their faulty design, as they were to lend at lower rates than their cost of funds. The net profit of RRBs at the aggregate level increased from Rs 617.13 crore during 2005-06 to Rs 625.15 crore during 2006-07. The net worth of RRBs increased to Rs 4,526.48 crore during 2006-07, an increase of 13 per cent over the previous year. The performance of RRBs varied widely across regions. While all RRBs were in profit in the southern region, 29 (out of 31) in central, 14 (out of 16) in northern, 9 (out of 10) in western, 9 (out of 10) in eastern and 5 (out of 8) in north-eastern regions were in profit (NABARD, 2008).

Shrinkage in Commercial Banks' Involvement

Public sector commercial banks played a major role in rural transformation since their first phase of nationalization in 1969. Rural branches increased in number and banking network spread across the country. Commercial banks' share in total institutional credit also kept on increasing over time to reach over 60 per cent by 2003-04 (Mohan, 2006)¹⁶ However, after the Financial Sector Reforms, 1991, the commercial banks were asked to show profitability and viability and follow prudential norms of income recognition and asset classification. Added to this, a host of new private sector banks were permitted and foreign banks were allowed to operate, thereby mounting heavy competitive pressure on the public sector commercial banks. The public sector commercial banks entered into a race with the private and foreign banks for the urban segment rather than concentrating on semi-urban and rural segments where they have heavy presence and initial advantage.

As a result of liberalization in branch licensing policy, the rural branches dwindled in numbers after 1991, both in absolute and relative sense. The proportion of rural branches declined from 57 per cent in 1990-91 to 44.5 per cent in 2005-06 (Table 3). On an average, number of rural branches came down by 260 every year.

As a result of reduction in number of branches and general relaxation in the emphasis on priority sector lending, commercial banks' involvement in rural credit declined. The major brunt appears to have been borne by the weaker sections. Inequitable distribution of branch network and credit flow across regions is already well documented. Imagine the plight of weaker sections in a region with weak banking spread! The Situation Assessment Survey (SAS) of Farmers (59th Round NSSO) conducted in the year 2003, has estimated that over 50 per cent of farm households were financially excluded with a relatively higher proportion of exclusion among small and marginal farmers and tribals (NSSO, 2005) As per Chavan (2007), commercial banks were the most important source of credit for the *dalit* households in 1992 and the share of debt from commercial banks to *dalits* sharply declined between 1992 and 2002. The vacuum, thus created, was filled Primarily by professional moneylenders. While professional moneylenders did emerge in 2002 as an important source of credit for other rural households as well, their hold was much stronger over *davit households* than other households? 'Commercial banks data also indicated a growing failure on the part of domestic banks to meet the targets set for "weaker sections" (which included *davits*) after 1991. This finding has serious implications as, going by the history, high cost credit was used to rob the poor of their assets like land. Less dangerous, though ubiquitous, are the linked credit transactions where farmers may lose substantially and have been widely reported in the literature. A trader giving credit and indirectly forcing, with likelihood of exploitation, the farmer to sell through him in the product market is a common feature in the rural areas.

Yet another reason for the reduced commercial banking activity in rural areas is the staff restructuring. At one point in time, say, for about decade and a half after the bank nationalization, public sector commercial banks recruited professional staff (agricultural graduates and other specialists). From 1990s onwards, in the wake of the much hyped VRS scheme, they had to manage their business operations through a handful of not-so-well-suited personnel in many branches. This naturally reduced the outreach as well as quality in lending. Rural lending in a country like India is manpower-intensive and the cost control through staff pruning would be self-defeating and counterproductive.

It appears that the number of agencies in a system, thus, may not matter as much as their commitment to the rural development and adaptability to the emerging demands.

Summary and Conclusions

Public policy on rural credit in India has been focused on institutionalization as a means of providing cheaper credit to farmers. As a result, the share of private moneylenders had decreased substantially from 93 per cent in early-1950s to 31 per cent by 1991. Disturbingly enough, they have emerged as an important source, more so for the resource-poor with a share of 39 per cent by 2002. The multiagency system onset for giving a wider choice to farmers has turned out to be ineffective due to deficiencies of design and architecture. Also, ailing cooperatives, backtracked RRBs and commercial banks with waning interest in rural credit have contributed to the ineffectiveness of the multiagency system, hampering the credit delivery. Several measures have been taken to revitalize the system from time to time. Cooperatives are given package assistance for revival following Vaidyanathan Committee Report. RRBs have been amalgamated and are being given capital to cleanse up their balance sheets. Commercial banks have been successfully involved in Farm Credit Package for doubling the credit and other initiatives of Government of India. The SHG-bank linkage has been promoted on a large scale to supplement rural credit delivery. But, the high transaction costs make it a costly alternative, especially when the business is handled solely by NGOs/MFIs. A thorough overhauling of the rural credit system and its restructuring is the need of the hour. However, it cannot be effective if done alone in isolation without revitalizing the Indian agriculture itself.

In view of the importance of rural credit to agriculture and rural development, thesis has examined a few structural constraints that hamper the credit delivery and has discussed some of the measures taken to improve the situation. The public policy on rural credit in India has been focused on institutionalization as a means of providing cheaper credit to farmers. As a result, the share of private moneylenders has decreased substantially from 93 per cent in early-1950s to 31 per cent by 1991. Disturbingly enough, they have emerged as an important source, more so for the resource-poor with a share of 39 per cent by 2002. The multiagency system onset for giving a wide choice to farmers has turned out to be ineffective due to deficiencies of design and architecture. Also, ailing cooperatives, backtracked RRBs and commercial banks with waning interest in rural credit have contributed to the ineffectiveness of the multiagency system, hampering the credit delivery. Several measures have been taken to revitalize the system from time to time. Cooperatives are being given a package assistance for revival following the Vaidyanathan Committee Report. RRBs have been amalgamated and are being given capital to cleanse up their balance sheets. Commercial banks have been successfully involved in 'Farm Credit Package' for doubling the credit and other initiatives of Government of India. The SHG-bank linkage has been promoted on a large scale to supplement rural credit delivery. But, its high transaction costs make it a costly alternative, especially when the business is handled solely by NGOs/MFIs. A thorough overhauling of the rural credit system and its restructuring need of the hour. However, it cannot be effective if done alone in isolation without revitalizing the Indian agriculture itself.

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