7 AGRICULTURAL FINANCE

7.1 *Need and Classification of Agricultural Finance*

7.2 *Sources of Agricultural Finance*

(A) *Non-Institutional*

(B) *Institutional*

7.3 *National Bank For Agriculture and Rural Development (NABARD)*

7.4 *Limitations of Institutional Finance*

7.5 *Suggestions*

7.1 NEED AND CLASSIFICATION OF AGRICULTURAL FINANCE

Finance is required to mobilise the inputs required to carry out production of goods and services. Agriculture is no exception to this. Poverty prevents majority of the farmers from modernising the method of cultivation. Availability of finance easily and at favourable terms, therefore, is essential.

In the post independent period the situation has been changing. Yet the traditional or non-institutional sources continue though with the reduced importance as suppliers of agricultural credit.

At present, National Bank for Agriculture and Rural Development (NABARD), Commercial banks, Regional Rural Banks (RRBs) and Cooperative Banks through their various schemes provide major part of the agricultural credit.

NEED FOR FINANCE

Finance or money capital is one of the important factors in agricultural development. As discussed earlier, poverty prevents farmers from improving cultivation. The quantity and quality of the inputs applied depend on the financial strength of the farmer. Insufficient income and inability to obtain finance on reasonable terms result in a state of indebtedness and vicious circle of poverty. Availability of enough finance from the right sources and at the right time would give them the required big push to come out of the vicious circle of poverty that a large number of farmers suffer from.

CLASSIFICATION OF AGRICULTURAL FINANCE

Short term finance is required for consumption and to carry out farming and other activities. The former includes providing livelihood specially during the off season and social and religious ceremonies. Purchase of seeds, fertilizers, fodder and some simple equipment comprise the second category.

To meet these expenses, the loans required are **short-term**, that is, a period of **upto 15 months**. Such loans are required to provide for the **working capital** and usually repaid after the harvest.

Medium-term finance is needed for purchasing cattle, equipment or any other requirements for improving cultivation or income earning activities. Such loans are for a period of **15 months to 5 years**.

Long-term finance is required for effecting major changes. They include buying additional land, addition to the capital stock such as irrigational facilities, purchasing costly agricultural machinery having long life span or paying off old debts. To meet these requirements farmers are required to borrow loans for a period of **more than 5 years**.

Productive and Unproductive : Agricultural credit can also be classified as productive and unproductive. The former is for the purchase of different types of inputs which improve the productivity and the total production. Credit spent in social ceremonies like festivals, marriage, birth and death ceremonies though essential is unproductive expenditure and adds to the debt burden of the farmers who are already poor. However, under inclusive finance, credit is required to extended even for such unproductive purposes.

7.2 SOURCES OF AGRICULTURAL FINANCE

Agricultural credit can be secured from various sources which can be broadly classified into **(1) Non-Institutional** and **(2) Institutional.**

A. NON-INSTITUTIONAL CREDIT

At the beginning of the planning period, non-institutional sources played a prominent role in supplying rural credit. In 1951, 92.7 per cent of rural agricultural credit was provided by non-institutional sources. Money lenders figured prominently by providing 69.7 percent of the credit. They still constitute the major source of non-institutional credit. The second important role was of relatives and friends, leaving the third place to traders, the landlords being the last, extending only 3.3 percent of the credit.

At present the share of non-institutional finance is reduced to about 20 per cent. Small and marginal farmers however depend on them upto 40 percent of their credit. After the nationalisation of major commercial banks, subsequently with the lead bank scheme and the establishment of National Bank of Agriculture and Rural Development (NABARD), with more new and innovative schemes, the non-institutional credit has decreased significantly.

(a) Merit of Non-Institutional Credit

(i) It is **easy to obtain loan** as the lenders and borrowers are known to each other.

(ii) **Simple Procedures** are followed while giving loans. Very often it is only on oral guarantee. However when the amount is comparatively large, a written guarantee is obtained.

(iii) **Easy access** and no formal timings to approach the money lenders, traders or landlords. During an emergency even at midnight a borrower could obtain loans.

(iv) **No Restriction** is imposed on the use of the loan. It is granted for productive as well as non-productive purposes.

(v) **Consumption loans** are also available from money lenders and others. Money required for marriages and other social celebrations and even for death ceremonies is available without much delay. For these purposes it is not possible to obtain loans from the institutional sources.

(b) Demerits

(i) **Exorbitant rate of interest** is charged by money lenders and others making it impossible for the farmers to redeem the loans.

(ii) **Indebtedness** is the main problem arising out of rural credit. The burden goes on accumulating and in certain cases it leads to perpetual burden.

(iii) **Loss of land and property.** Failure to pay the loan and interest results in loss of land and property to the lenders of credit. Small and marginal farmers are deprived of the ownership of their land when they cannot repay the credit.

(iv) **Malpractices** are indulged in the form of obtaining thumb impression or signature on blank bond/stamp papers and misusing them and thus depriving the farmers of their property and assets.

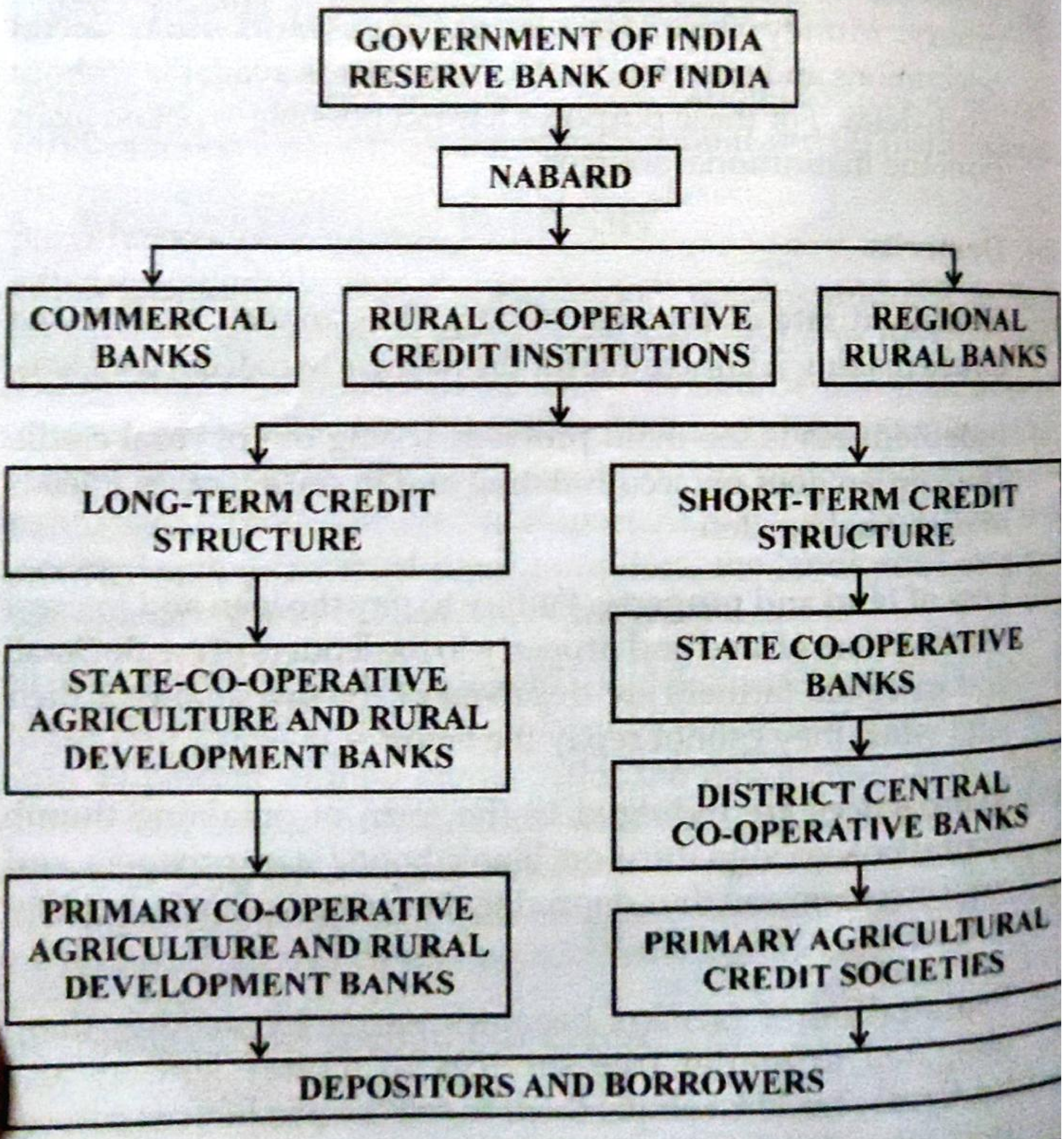
(v) **Exploitation** of farmers becomes easier by making them obligated to render free services to money lenders and landlords. Traders compel them to sell the products at a lower price immediately after the harvest.

(vi) **Bonded labour** is the result of indebtedness of small and marginal farmers. In certain cases it may even continue from generation to generation as they cannot redeem the debt due to high interest and other malpractices resorted by the lenders.

B. INSTITUTIONAL CREDIT

The share of institutional credit has increased substantially. Within this sector, cooperative and commercial banks have been playing major roles in rural/agricultural credit. Let us discuss in brief the major sources of institutional credit.

Chart 7.1 : Structure of Agricultural Credit System In India



The amount of credit supplied by three institutional sources is shown in Table No. 7.1.

Table 7.1 : Flow of Institutional Credit to Rural Area (Agriculture and Allied Activities)

Percentage Share

Agency	1970s	1980s	2000-2001	2011-2012	2016-2017
Cooperative Banks	77.0	55.9	39.0	17.21	13.4
Commercial Banks	21.0	38.9	53.0	72.13	75.0
Regional Rural Banks	2.0	5.3	8.0	10.65	11.6
Total	(100)	(100)	(100)	(100)	(100)

Source: RBI Annual Reports.

The above table tells us that, of the total institutional credit in 2016-17, 75.0 per cent comes from commercial banks, 13.4 from co-operatives and 11.6 per cent from RRBs. It is not very encouraging to note that the co-operatives' share has been declining over the period. Co-operatives and RRBs which are specially meant and committed to the agricultural finance must be more active in financing this sector.

(I) COMMERCIAL BANKS

They played a comparatively less significant role till the nationalisation of the major commercial banks in 1969. The number of rural branches increased from less than 25 percent of the total in 1969 to about 35.3 percent of the total in March 2017. In 2016-17, the commercial banks' lending to agriculture amounted to about 75% of the total institutional credit to agriculture.

Commercial banks' lending can be classified as (i) short term, (ii) medium and long term, (iii) direct finance and (iv) indirect finance.

Short-term finance is extended for purchasing fertilisers, seeds, pesticides, etc. It provides the required working capital. More than 50 percent of commercial banks' agricultural finance is in this category.

Medium / Long-term : Commercial banks lend medium term but do not encourage the long-term finance. Money borrowed under this is usually used to purchase cattle, equipment and improvement of land. In recent years, however, banks have become liberal and therefore, have widened the scope of medium term lending. Accordingly some of the medium term lendings get extended to long term. Nearly 50 percent of banks' lending to agriculture fall under this group.

Direct finance is meant for expenditure on purchasing pump sets, tractors and other agricultural machinery, construction of wells, bore-wells and tube wells, purchase of ploughing animals, purchase and development of land, and for many other activities. Lending under direct finance has been around 10 percent of the total lending.

Indirect finance is granted to cooperative societies of various types to enable them function more effectivity. Commercial banks also subscribe to the debenture of central land development banks besides extending loans to them. Indirect finance is provided to Food Corporation of India, the State Government and other agencies for procurement, storage and distribution of foodgrains. Not more than 4 percent has been advanced under this scheme.

Lead Bank Scheme was launched by the Reserve Bank of India to make individual commercial banks responsible for the development of individual districts. The banks were expected to prepare District Credit Plan (DCP) in terms of both physical and financial targets for the overall development of a district through the coordinating efforts of all the three institutional financing agencies viz. the branches of Commercial Banks, Regional Rural Banks and Cooperative Banks. The banks were given the responsibility of monitoring the progress. This was a joint venture wherein different institutions put together their expertise and financial strength to help agriculture in general and rural areas in particular.

(II) CO-OPERATIVES

Co-operative credit societies were established to provide rural credit at a lower cost. The co-operative banks provide short term and long term loan through credit societies via land development banks. They have well established organisations as shown in the following chart.

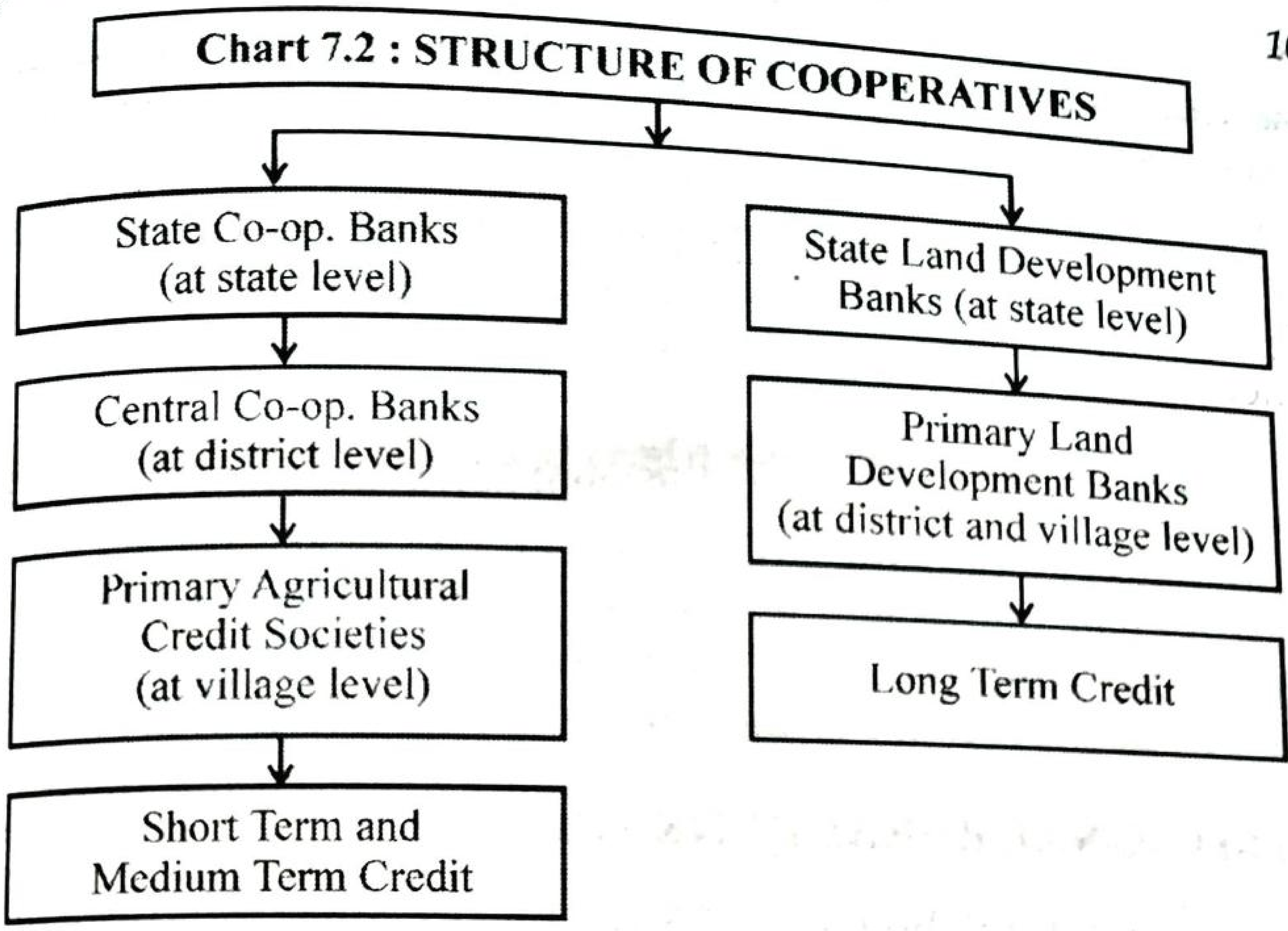


Chart 7.2 : STRUCTURE OF COOPERATIVES

SHORT AND MEDIUM TERM CREDIT

State Co-operative Banks are the apex of the co-operative credit structure. They act as a link between the central co-operative banks and the National Bank for Agriculture and Rural Development (NABARD).

Central Co-operative Banks function at the district level and provide a link between primary societies and state co-operative banks. The primary societies borrow money from the state co-operatives through central cooperatives.

The primary credit societies are at the base level, that is, at the village level. They provide **short and medium term** credit to the farmers. Besides credit they also help farmers by supplying seeds, fertilizers, insecticides, agricultural equipment, marketing and farm produce etc. To combine other services along with credit, Farmers Service Societies (FSS) were established. On the recommendations of the study team appointed by the Government of India in 1971, Large Sized Adivasi Multi Purpose Co-operative Societies (LAMPS) were organised in the adivasi and tribal areas. LAMPS provided a variety of services from credit to marketing under one single roof.

... share of **co-operative banks** has declined from more than 50% of the institutional lending in 1990-91 to around 13.4 percent in 2016-17. However in absolute terms they have made good progress. By now, the cooperatives have covered more than 97% of the villages with almost 900 lakh members.

LONG TERM CREDIT

For long term credit, land development banks are established. They work at two levels. At the district level, there are **Primary Land Development Banks** and at state level **State Land Development Banks.** Loans from the land development banks are for a period of 10 to 15 years and at times they are extended for upto 20 years.

(III) REGIONAL RURAL BANKS (RRBS)

They were established in 1975 on the recommendation of M. Narsimha committee. These banks were regionally based, rurally oriented and generally sponsored by scheduled commercial banks. Some private sector banks as well as State Cooperative banks have also supported the RRBs. At present there are 56 RRBs.

Objectives

(i) To develop rural economy.

(ii) To extend finance to farmers specially small and marginal, village artisans, small entrepreneurs and agricultural labourers.

(iii) To supply credit to those areas where other financial institutions are not active.

RRBs lent more than ₹ 1000 billion of credit to agriculture and allied activities in 2016-17. There has not been much progress in their share in recent years. Political interferences, pressure from vested interests and poor recovery are some of the serious problems that confront the RRBs.

To improve the functioning of the RRBs it is necessary to improve the capital base of these institutions, allow greater liberty in functioning, provide refinance at lower rate of interest and train the bank personnel in all aspects of agriculture and rural development.

Short term loans continue to dominate RRBs lending. It's share in the total lending is steadily increasing.

RECENT MEASURES

Government has taken several measures for improving the flow of agricultural credit.

1. The flow of agricultural credit since 2003-04 has consistently exceeded the target.
2. Farmers have been receiving crop loans upto a principal amount of ₹ 3 lakh at 7 percent of interest since 2006-07. Since 2012-13 the effective rate of interest has been 4 percent for farmers who repay their loans promptly. This concession was introduced under **interest subvention scheme.**
3. Post-harvest loans were granted against negotiable warehouse receipts at a commercial rate of interest. Such measure prevents distress sale immediately after harvest.
4. The Government is implementing a revival package for short-term Rural Co-operative Credit structure involving a financial outlay of more than 13 crore.
5. As a safeguard against the risk arising out of weather changes, natural disasters and uncertainty in output prices, government has introduced a number of crop insurance schemes.

7.3 NATIONAL BANK FOR AGRICULTURE AND RURAL DEVELOPMENT (NABARD)

The NABARD was established in 1982 as an apex bank for agricultural and rural credit. An apex financial institution was necessary to provide direction, infuse dynamism and provide sufficient finance in the form of refinance.

Role and Functions of NABARD

To work as an **apex body** and **provide finance through** cooperatives, commercial banks and RRBs.

To promote integrated rural development by providing credit to agriculture, small-scale industries, cottage and village industries, handicrafts and other allied economic activities in rural areas.

To **promote and develop** financial institutions specially in those areas where there are no or not enough number of financial institutions.

To **inspect** district and state cooperative banks and RRBs.

To **reduce regional imbalance** in the availability of finance.

To introduce **innovations** in the form of **new schemes.**

AGRICULTURAL FINANCE BY NABARD

As a refinance institution, it provides refinance to State Co-operative banks, RRBs and other rural financial institutions.

- Gives long-term loans to state governments to enable them to subscribe to the share capital of co-operative credit societies.
- Provides long-term loans to any institution approved by the Central Government, for the purpose of agricultural finance.

(a) **Micro Finance :** This scheme was introduced in 1992 as a pilot project under which formal banking system reaches the microentrepreneurs including farmers. The scheme has been implemented through **Self-Help Group (SHG)** and bank linkage programme. The beneficiaries of this programme comprise the **marginal farmers,** landless labourers, artisans and craftsmen and people engaged in small business like hawking and vending in the rural areas.

The SHG Bank Linkage Programme is implemented by commercial banks RRBs and co-operative banks. The programme has enabled about 100 million poor families to gain access to micro-finance from the banking system. The programme, however, is not very successful due to problems associated with the recovery of loans.

b) **Bulk Lending Support to NGOs:** NABARD introduced this scheme for on-lending to rural micro and household enterprises NGOs receive finance under this scheme.

OBJECTIVE QUESTIONS

A. Choose the correct answer and rewrite the statements:

1. Major part of the agricultural credit is supplied by
   (a) Money lenders (b) Commercial banks
   (c) Co-operate banks
2. RRB's were established to provide credit to
   (a) only to non-agricultural activities in rural areas
   (b) both agricultural and non-agricultural activities
   (c) only to agricultural activities
3. Kisan credit card was introduced by
   (a) RBI (b) NABARD
   (c) Co-operative banks
4. Non-institutional credit very often leads to
   (a) indebtedness (b) exploitation of borrowers
   (c) loss of land and property (d) all the above
5. Farmers require long-term credit for
   (a) consumption expenditure (b) purchase of land
   (c) purchasing seeds and fertilizers
6. Regional Rural Banks were established to provide finance to
   (a) small and marginal farmers (b) village artisans
   (c) agricultural labourers (d) all the above

Ans.: (1) - (b), (2) - (b), (3) - (b), (4) - (d), (5) - (b), (6) - (d)

B. State whether the following statements are true or false with reasons:

1. Institutional finance has eradicated non-institutional finance in the rural sector.
2. Microfinance is highly successful in providing rural credit.
3. It is more difficult to obtain non-institutional credit than institutional credit.
4. Major portion of agriculture finance comes from traditional sources.
5. Finance from traditional sources is easy to access.
6. Share of co-operative banks in institutional agricultural finance is declining.

7. NABARD has introduced innovative methods of providing agricultural finance.

Ans.:

1. *False; For Reasons : Refer Section 7.2.*
2. *False; For Reasons : Refer Section 7.3 (I) (a)*
3. *False; For Reasons : Refer Section 7.2 (A) (a) (iii)*
4. *False; For Reasons : Refer Section 7.4.*
5. *True; For Reasons : Refer Section 7.2.*
6. *True; For Reasons : Refer Section 7.2 (B).*
7. *True; For Reasons : Refer Section 7.3.*

C. Match the Columns :

Column A	Column B
(1) Non-institutional Finance	(a) Co-operative Banks
(2) Institutional Finance	(b) Traders and money lenders
(3) Kisan Credit Card	(c) RBI
(4) Self-Help Group (SHG)	(d) Micro-finance
	(e) NABARD

Ans.: (1) - (b), (2) - (a), (3) - (e), (4) - (d)

D. Fill in the blanks :

1. At present ______ sources provide a major share of agricultural finance.
2. Among the institution ______ banks provide larger share of agricultural finance.
3. Micro finance scheme provides finance to the farmer through ______
4. Kisan Credit Card Scheme was prepared and introduced by ______.
5. Formalities and requirement of collateral security discourage farmers from approaching ______ ______ for loans.

Ans.: (1) Institutional (2) Commercial Banks (3) Self Help Group (SHG) (4) NABARD (5) Financial Institutions