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Agricultural Credit Policy in India - Need for Shift from Supply-Led To Demand-Driven Credit

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ABSTRACT

In pursuance to the recommendations of the All India Rural Credit Review Committee [1969] the Government of India directed the nationalized banks including the State Bank Group & later on private sector commercial banks to finance farmers in order to significantly increase food output in particular and substantially raise agricultural growth rate in general. Government, also, adopted a multi-agency approach involving vast rural network of cooperative credit institution and regional rural banks. From time to time the Government introduced a plethora of directives virtually regulating the banks beyond one can expect. In the process, approach to agricultural credit policy in India and many developing countries since the 1960s has been "*supply-led rather than demand-driven"* which of course facilitated farmers to usher in *Green Revolution.* However, over a period of time this approach resulted into large-scale over dues building huge amount of non-performing assets, making banks financially unviable and forcing the Government to recapitalize them, among others. In this context, this development perspective article attempts to briefly highlight pertinent aspects of supply-led approach and suggests the immediate need to search & reinvent the agricultural credit delivery approach emphasizing demand-driven

Keywords: RFI, Green Revolution, NABARD, RIDF, ANBC, NABARD, HTM, RBI, SHG-BLP, BRI-UD, BAAC

I. INTRODUCTION

For developing countries, more importantly India, provision of financial services is *sine qua non* in rural areas, which comprise a heterogeneous, farm & non-farm population of varying income levels, through different types of formal, semi-formal and informal institutional arrangements. Financial services and products are quite diverse and include savings, deposits, credit, remittances or transfer of money, payment services and insurance. Generally, formal Rural Financial Institutions [RFI] focus on agricultural or farm finance [agricultural and allied sectors] and non-farm finance [manufacturing &, processing and businesses & services] in rural areas. Since the mid-1990s micro-finance as a sub-sector of the financial sector and important component of the financial inclusion program has acquired added significance. RFIs in developing countries have been actively engaged in providing rural finance, more importantly credit, since early 1970s which facilitated India in particular to trigger *Green Revolution* making country self-sufficient in food output. However, huge gap exists between the supply and demand for rural finance in most countries. This is attributed to, among others, at the macro-level, urban biased policies; risk due to unpredicted farm output & agricultural prices for inputs and outputs; and financial policies, viz. interest rate cap and usury laws. As a result, the returns earned on rural investments are often low.

II. METHODS AND MATERIAL

Financial Sector Reforms

Implementation of financial sector reforms since the early 1990s aims at ensuring that varieties of market-based financial services are available to all categories of farmers & rural farm households, traders, agro-processors and other non-farm entrepreneurs. To achieve objectives of financial widening [expanding coverage] and deepening [increasing quantum of finance] RFIs require a thorough knowledge/insight of rural economy, the existing status of policy & legal framework for rural finance and rural households' access to financial & non-financial support services. The policy makers [bankers and Governments] in developing economies need to recognize ground realities of farm/rural financing and should formulate appropriate policy for agricultural/rural lending; organizational/management structure, human resource development and training to meet the financial needs of various classes of farmers; and drafting manuals on credit appraisal, rural branch management operations and training for bank staff and rural clients. The specific areas that require understanding of ground realities include [i] high financial transaction costs involved in serving dispersed and small farm households [ii] understanding the seasonality of agriculture that requires timely disbursement of credit to facilitate farmers to prepare land, purchase inputs, planting of crops, harvesting and post-harvesting operations [transport, storage/preservation, processing, marketing etc.]. Besides, farming requires two types of credit [a] short-term working capital for seasonal agricultural operations and [b] long-term credit for long-term investment purposes [iii] farmer's low level of technical know-how to manage farm resources sustainably resulting in low profitability of on-farm investments [iv] agricultural risks, such as weather aberrations, production loss/fluctuations, marketing and price risks requiring appropriate risk management techniques for farmers and banks [v] in view of the limited availability of conventional bank collateral that farm households can offer, the need to develop appropriate collateral substitutes and simplified procedure for registration and enforcement [vi] small farmers and low-income farm households often require finance to meet their consumption needs, social and religious obligations, which significantly impact on their loan repayment capacity and [vii] while bank staff needs to be trained to manage loan portfolio qualitatively, farmer clients need training in capacity building & skill improvement to manage farm & finance [viii] provision of financial literacy and credit counseling services to help farmers use loan productively, increase income and make on time repayment.

Directed and Subsidized Credit

In early 1960s, developing countries, including India, accorded priority to develop agriculture in order to boost food output and attain self-sufficiency as well as improve the standard of living of poor rural households. The agricultural research institutes evolved technology to usher in *Green Revolution* involving use of high yielding & hybrid seeds, chemical fertilizers, pesticides and irrigation which held promise to substantially increase crop productivity per unit of area, particularly of rice and wheat. While farmers were enthusiastic to adopt the yield-enhancing technology it was, however, costly and because of pecuniary poverty of a vast number of small farmers they were financially handicapped to meet the working capital from their own resources, leave alone investment needs. Government, therefore, recognized that agricultural credit was absolutely a prerequisite to facilitate farmers to buy improved seeds, fertilizers, pesticides and develop irrigation facilities, which constituted the critical component of the yield-enhancing agricultural technology. Agricultural credit in developing countries, therefore, was considered an important means to [i] accelerate process of agricultural development in general & improve crop productivity, farm output and exports in particular and [ii] ensure livelihoods of all those engaged in agriculture, reduce poverty, and guarantee national food security. For small farmers timely, reliable and easy access to credit was *sine qua non* not only to enable them to purchase & use costly inputs and stimulate national farm output but also promote rural inclusive growth through rural income distribution. Accordingly, Governments of developing countries on their own as also with the aid of international donors introduced a plethora of credit-based schemes, projects and programs around the world, especially in Asia and Latin America. Recognizing the high costs and risks involved in implementing these projects in rural areas the formal financial institutions were not inclined to expand their operations into rural areas, excepting a few only to tap rural savings and use in urban centers.. Thus, in 1970s most Governments themselves considered it necessary to intervene and evolved agricultural credit policy to provide farmers the targeted credit at subsidized rate of interest [below market interest rates] through Government-owned and managed banks or RFIs. This traditional approach usually implied a high level of Government intervention in the rural financial markets. Governments and international donors in their efforts to increase width and depth of credit in rural areas intervened in rural financial markets emphasizing policy, methods, system & procedure on [i] opening rural branches in a time bound program & recruitment of technical staff [ii] fixing lending targets, credit-deposit ratio for rural areas & other requirements on banks and RFIs for on-lending to farmers [iii] putting in place refinance schemes or discount facilities to augment financial resources for lending to farmers [iv] loans at subsidized or concessional rate of interest [v] provision of credit guarantee schemes to motivate lenders and [vi] linking Government's agricultural development programs involving capital subsidy linked with bank credit and fixing targets in terms of number of farmers as also lending targets for Government agencies, banks and RFIs. RFIs, in their enthusiasm to achieve credit targets, assigned low priority to mobilize savings and allocate resources. This necessitated Governments to formulate credit-based agricultural development projects and channel financial resources [sought from donors & international financial agencies] through State owned banks and RFIs. These programs and RFIs served as conduits to provide targeted & subsidized credit to small and marginal farmers, among others, to develop irrigation potential to raise farm productivity and food output In the process, the credit programs were supply-driven [target-based] rather than demand-driven[assessment of effective credit demand] and multilateral and bilateral donors supported the approach initiated by Governments and continued to fund a large number of the targeted/supply-driven projects. The Governments' interventions were intended to increase farm lending by reducing the costs and risks to lenders that disbursed loans to targeted rural clients and preferred/priority sectors of economy. Policy and programs of subsidized interest rates and interest/loan waivers and write-offs were also used to help farmers reduce the debt burden following floods, droughts, cyclones and periods of low farm prices.

Current Status of Directed Credit to Agriculture in India

- Deploy 15% of total outstanding credit as direct agricultural credit by March 1985 & 16% by March 1987 & thereafter 18%
- From April 1989, banks to undertake detailed credit deployment task through formulation of village level credit plans in accordance with comprehensive directives issued by the RBI
- A wholesome Agricultural Debt Waiver & Debt Relief scheme announced by the Government in 1990 & 2008
- Since 1994-95 Union Minister for Finance has been stipulating targets for disbursement of agricultural credit in the Annual Budget
- From 1994-95 the RBI directed banks to prepare special agricultural credit plan on an annual basis considering fixing 20% to 25% additional targets over the disbursement in the previous financial year
- From 1995-96 when banks do not achieve the prescribed agricultural credit targets [18% of ANBC] they have to invest the shortfall in the Rural Infrastructure Development Fund [RIDF] established with NABARD. However, this RIDF deposit carries low rates of interest [2% to 3%].
- From 1998-99 banks to provide Kisan Credit Card evolved by NABARD to facilitate farmers required financial liquidity & avail credit as and when needed.
- From August 2001, the Government directed banks to finance for purchase of land for agricultural purpose.
- Agricultural credit policy announced in June 2004 included, among others, rescheduling of short-term loans into medium & long-term loans & fixing the higher agricultural credit targets under the special agricultural credit plans & directions to double the flow of credit to agriculture within three years commencing from 2004-05.
- Banks directed to extend financial assistance to redeem loans taken by farmers from private sources
- From April 2007 directed credit to agriculture at 18% to be calculated as a percentage of adjusted net bank credit or credit equivalent amount of off-balance sheet exposure whichever is higher as on March 31 of the preceding accounting year instead as percentage of net bank credit earlier. ANBC means net bank credit plus investments made by banks in non-statutory Liquidity Ratio bonds held in HTM category. Further, total credit to agriculture should be 18% of ANBC subject to indirect credit not exceeding to 4.5% of ANBC
- Banks to lend 10% of ANBC or credit equivalent amount of OBE whichever is higher to weaker sections of the society
- From 2006-07 farmers to receive crop loans up to principal amount of Rs0.3 million at 7% interest rate & the Government to provide the necessary interest subvention to NABARD for this purpose

- From 2007-08 the Government announced that additional 2% interest subvention for short-term loans to those who repay on time.
- For achieving financial inclusion targets under the National Plan for Financial Inclusion [2010] commercial banks to increase coverage of farmers by extending finance at the rate of additional 250 farmers per branch & financing five million new farmers in a year.
- Recently, the RBI has directed Scheduled Commercial Banks to achieve target of 8% lending to Small &Marginal Farmers [SMF] within the 18% target set for agriculture, to be achieved in a phased manner, 7% by March 2016 and 8% by March 2017. For the purpose of computation of 7-8% target, SMFs will include: marginal farmers [landholding of up to 1 hectare] and small farmers [landholding between 1 and 2 hectares], landless agricultural laborers, tenant farmers, oral lessees and share-croppers

Outcome of Supply-led Credit

With the supply-led targets for scheduled commercial banks including regional rural banks in India disbursement of agricultural credit [Rs29,601.85 billion] in last five years [2011-12 to 2015-16] has substantially shot up [160.29%] as compared to Rs18,467.85 billion disbursed in past 41 years [1969-70 to 2010-11] & their share is 61.58% in total agricultural credit disbursed[Rs48069.70 billion] during 46 years. Average recovery percentage of direct agricultural credit of scheduled commercial banks during 2011-12 to 2013-14 was 74.6% of total demand [Rs.7328.8 billion]. Gross non-performing assets as percentage to total outstanding agricultural credit of scheduled commercial banks progressively increased from 1.95% in 2008-09 to 4.72% in 2012-13.share of outstanding debt of cultivators from institutional sources improved from 10.2% in 1951 to 66.3% in 1991 but declined to 61.1% in 2002 & 64.0% in 2013. Between 2008-09 and 2011-12 the Government of India waived sum of Rs.525,168..60 million under agricultural debt relief scheme.

After some time when the impact of this approach was evaluated it was observed that this approach focusing on *directed and subsidized* credit did not produce the expected results. The main reasons, among others, were that [i] State owned banks were established more for political rather than socio-economic considerations and policy makers did not give a serious thought to operate RFIs as *operationally viable and financially sustainable institutions*.[ii] Since they were established to channel subsidized Government and donor funds to farmers they did lack the market and financial discipline and could not operate as commercial banks for exploring and exploiting rural business opportunities. [iii] Experiences suggest that the provision of credit more or less depended upon political interests and commitment [iv] The irregular availability of loan funds, prescription of interest rate ceilings and the periodic write-offs of overdue loans seriously jeopardized the effectiveness of lending operations & financial viability of the State owned banks.[v] Since the performance of these banks was measured in terms of loan disbursed and loans outstanding, rather than actual number of intended small and marginal farmers assisted, repayments mobilized and increase in the farm output, these banks were tempted to grant sizeable loans predominantly to well established large farmers [vi] In several instances, this resulted into rent-seeking behavior of the farmers, who benefited from the subsidized interest rates that were set by the Governments [vii] A good number of agricultural credit programs designed did not reflect the actual needs of small farmers at the field level as well as did not consider the high costs that were associated with farm lending [viii] These banks primarily concentrated only on farm lending which exposed them to high level of risks. This called for frequent restructuring and rescheduling of overdue loans which further adversely affected recovery process at bank level as well as it vitiated the recovery discipline/climate among farmers [ix] The objectives of stimulating asset formation, income expansion and poverty reduction in rural areas were not achieved. Though this approach helped some developing countries, especially in Asia, to improve agricultural yields and farm output in the short-term, it proved to be costly and unsustainable over the long term, and it failed to reach the majority of rural households. The major emphasis of RFIs on *disbursing agricultural credit* impacted adversely on portfolio quality and accorded low priority to non-farm sector development, savings mobilizations, and efficient rural finance intermediation. The focus on exclusive lending only for agricultural purposes resulted in the general neglect of the potential benefits of supporting growth-intensive investments more appropriate for the rural poor or small, off-farm enterprises. In many cases, costly bailouts or recapitalization of public sector banks and state-owned agricultural credit institutions undermined the development of private-for-profit RFIs. Most Governments used RFIs for serving political cause disregarding the huge costs and high level of risks of supplying financial services. Subsidized interest rates did not even cover costs of borrowing, leave alone operational costs, making RFIs unviable and shaking the confidence of depositors. The cheap credit encouraged unprofitable investments and led to loan portfolios with concentration of relatively rich and politically powerful borrowers resulted in the buildup of huge non-performing assets, which in many cases were required to be written off. Also, subsidized agricultural credit often resulted in production inefficiencies by targeting inappropriate financial products and creating artificial demand for capital intensive investments that "crowded out" abundant labor in rural areas. In some cases borrowers intentionally defaulted, because guided by past experiences, they believed that Government would waive or write-off their loans or not take action against defaulters in farm sector. This therefore encouraged financial indiscipline and weakened intermediaries. Several RFIs became insolvent and were either restructured/recapitalized or liquidated. Refinance schemes as well as provision of donors and Government funds that RFIs used to channel subsidized services discouraged savings mobilization and financial intermediation.. Hardly efforts were made to put in place bare minimum rural infrastructure that can improve credit absorption capacity of farmers & geographical area and stimulate agricultural development & growth rate.

Experiences

The policy of supply-led, directed and subsidized credit and programs in most countries, including Brazil, Indonesia, Mexico, Sri Lanka, India and centrally planned economies was the dominant financial instrument used to accelerate agricultural growth during three decades of 1970s to 1990s. The Governments in many countries attempted to augment the financial resources available for investment in agriculture by introducing regulations affecting urban-based commercial banks, viz. banks that are normally not willing or actively involved in agricultural lending are required by law to lend to agriculture a targeted percentage of their total loans. Either they have to disburse this targeted share of their portfolio directly in the farm sector or provide indirectly through specialized banks which can on-lend these compulsory funds to the ultimate borrowers. In some cases, shortfalls of commercial banks which were not able to lend the required amount directly to the ultimate borrowers constitute a considerable part of agricultural development banks resources, such as Agricultural Bank of Iran and the Bank for Agriculture and Agricultural Cooperatives in Thailand in the past. This mandated policy facilitated many countries in Asia to establish fairly a large portfolio of targets for commercial banks. The target of allocated credit in the agricultural sector was set at 25% in Iran and the Philippines and at 20% in Thailand. In India the revised guidelines on lending to agriculture effective from April 30, 2007 seek to enlarge the base of the agricultural lending. The targets of 18% for lending to agriculture stipulated for public and private sector banks have now been linked to the adjusted net bank credit [ANBC]. The shortfalls in achieving the targets have to be deposited with NABARD under the RIDF which can be lent on soft terms to State Governments for creating rural infrastructure that covers 35 activities under sectors viz. agriculture & rural development, rural connectivity and social sector.

While there has been a shift in some components from the directed agricultural credit approach to market-driven one there has been conspicuous decline of institutional credit to agriculture as most banks have accorded low priority to expand their rural branch network & develop agricultural lending expertize to finance farmers as a result of which a large number of farmers still continue depending upon/even switched over to non-institutional sources. Thus, directed agricultural credit program still plays important role in some developing countries such as India & the Philippines in one or the other forms. In countries such as Chile, El Salvador, Indonesia, Peru & Uganda only a few components of the earlier approach continue whereas in most other countries the shift to new approach has been partial in respect to interest rate deregulation, reduction in subsidies & concenssionary funds from central banks to lenders.

Lessons to learn

The literature on the policy of supply-led directed and subsidized credit to agriculture implemented in developing economies provide valuable insight and lessons that can help policy interventionists better understand the need to switch over or evolve demand/market-driven approach and programs to achieve the expected objectives and ensure that RFIs are operationally viable and financially sustainable in the longer term. These lessons are [i] it is universally believed that rural poor need credit facilities as they often borrow from informal sources and they have no savings as also are not able to save. This belief is misplaced. In absence of serious endeavors by RFIs to study their household cash-flow and understand their irregular sources of income and specific purposes for which they need credit this belief continues. Now most developing countries including India have, since mid-1990s, have witnessed and documented evidences how poor have been savings and managing their household finance under the micro-finance programs and under the Self-Help-Group-Bank Linkage Programs [SHG-BLP].[ii] RFIs in their exclusive efforts to finance poor under programs of the Governments and international donors have neglected to mobilize rural savings from poor which has unfathomable potential as now acknowledged under micro-finance and SHG-BLP [iii] RFIs because of free flow of subsidized credit for on-lending to targeted clients did not endeavor to develop as banking and credit institutions in real term but assumed the role of Government's credit disbursal outlets in rural areas [iv] RFIs in this process did not develop efficient rural credit delivery system as it should have and this poor delivery system led to poor repayment culture and often concentrated more on rich farmers for aggressive disbursement to fulfill the targets, neglecting the poor for which the programs were meant [v] often rural rich securing credit from RFIs at concessional interest rates lent to poor at exorbitant interest rates and vitiated the rural financial markets and financial discipline. Worst was in evidence in some cases that these loans of RFIs were written off that benefited rich and punished the poor. [vi] RFIs in most cases financed rich farmers for farm mechanization [tractors, power tillers and combine harvesters] at concessional interest rates at the cost of the intended poor households.[vii] This approach based on increasing food output concentrated principally on lending for agricultural purposes and did not consider the potential of small non-agricultural rural enterprises or rural non-farm sector which was necessary to diversify credit portfolio, increase clients' income & minimize credit risk and in particular boosting overall rural economy.[viii] RFIs should consider financing all rural economic development activities and *"lead or create*"' development rather than "*follow*" development. For this the Governments have role and responsibilities to create enabling environment for RFIs through supportive macroeconomic policies and establishing institutions for effective regulatory, supervision and judicial systems, collateral registries, and credit information bureaus. Liberalizing restrictions on interest rates may be necessary in the initial stage but not a sufficient condition to create efficient and viable RFIs. Accordingly, all terms and conditions of loan contract [viz. loan term structure, interest rates, collateral, collection and contract enforcement mechanisms etc.] need to be evaluated, effects debated and policy modified to meet changing local needs and loan administration authority should be accountable to stakeholders. [ix] From time to time efforts should be directed to build organizationally, managerially and financially strong RFIs and weak ones should be restructured or even liquidated, in order to efficiently expand rural outreach and serve rural areas in a sustainable way [x] savings mobilization, insurance and remittance services are important for rural people which cannot be neglected but developed through market surveys [xi] RFIs in due course may have to commercialize their business operations and competition need to be encouraged to expand outreach and improve quality of services. [xii] a considered thought must be given to dispense with subsidies in any form, which should be judiciously utilized to develop institutional & physical infrastructure and capacity building of RFIs that can ultimately develop robust financial systems [xiii] The poor design and unsatisfactory performance of State owned RFIs and their continued access to concessional funds have not only discouraged private, for-profit financial intermediaries from engaging in RF intermediation but also has created serious operational problems for private , for-profit commercial banks which are now mandated by law to open rural branches and fulfill stipulated credit targets for agriculture and achieve financial inclusion as a corporate policy.

The disappointing outcome of the traditional approach of supply-led credit in resource-poor developing economies drew focused attention of policy interventionists to use these scarce, costly and demand-competing financial resources more efficiently in specific ways in pursuit of asset creation, rural income expansion and poverty reduction. Accordingly, the unsatisfactory experience with directed credit programs of 1970s and 1980s led to policy shift from channeling supply-led farm credit to evolving a policy and system to meet the demand for different types of rural finance services.

Demand-led Credit Approach

The demand-led credit approach now acknowledged as Financial System Approach to rural finance is a radical departure from the traditional supply-led approach. It began to emerge in the late 1980s, gained momentum in the mid-1990s and is being fine-tuned. It is based on the lessons learnt from the directed and subsidized credit approach and the emerging MF revolution. *This financial systems approach, using market principles to deliver financial services aimed at facilitating farm & rural development that promotes asset creation, income expansion and poverty reduction.* It considers finance as a powerful instrument to expand and integrate markets, rather than a policy tool targeted for specific market segments. Efficient financial markets are expected to improve the productivity of the factors of production and to improve inter-temporal resource allocations and management of risks. Therefore, finance should neither be controlled nor directed to pursue non-financial goals but needs to be promoted to achieve desired development. It is founded on the principle that a commercial and market led approach is most likely to reach large numbers of clients on a sustained basis. It recognizes that financial services are part of system of financial institutions, financial infrastructure, legal and regulatory frameworks, and social and cultural norms. Government has a role to establish a "*favorable or enabling*" policy environment, infrastructure and information system, and supervisory structure to facilitate the smooth functioning of rural financial markets. At the same time, it may play a more limited role in direct interventions.

The financial system approach advocates and emphasizes three priorities in developing rural financial markets, viz. [i] creating a favorable policy environment, including macroeconomic stability as well as reduction in the historical bias against the rural sector [ii] putting in place appropriate legal and regulatory framework, including significant improvement in the legal system and procedure for secured transactions, and adapting licensing requirement and regulation so that well performing RFIs are encouraged to legally provide a variety of financial services and products [not only credit] to poor and low income households and micro-entrepreneurs, and [iii] building the institutional capacity of RFIs and capacity building of their management and operating staff to deliver demand-led credit, savings and insurance services in a self-sustaining manner.

This approach further recognizes that financial services may have to be supplemented by [i] complementary investments that help rural population build assets and skills by developing economic and social infrastructure at the community level [ii] social intermediation to facilitate formation of Solidarity Groups [SGs], Self-Help-Groups [SHGs] and Joint Liability Groups [JLGs] or Credit Cooperatives or Credit Unions to build social capital [iii] training to impart technical, financial and management skills to clients, and [iv] supporting business-development services.

Bank Rakyat Indonesia

Bank Rakyat Indonesia [BRI] a State-owned commercial bank in Indonesia was established with the aim at developing agricultural sector. In 1970s Indonesian Government invested huge amount of oil wealth in agriculture for developing irrigation potential, evolving rice technology, building infrastructure, providing education and health services in rural areas where 80% population lived. This investment helped agriculture and rural industries support generation of rural employment, income and growth. In 1970s BRI opened more than 3500 village units to channel Government's subsidized credit to rice farmers under the country's rice intensification program during 1970s and 1980s. While the rice output increased substantially, credit component could not succeed. A large amount of subsidized loan, being at below market interest rate, was cornered by elite farmers and did not reach to poor farmers as was envisaged. Moreover, arrears and loses were high. Financial sector reforms were extended to rural areas and Government issued first major financial deregulation package in 1983. It removed credit ceilings and permitted banks to set their own interest rates on loans and deposits. The Government, also, decided to convert the subsidized unit *desa* of BRI into a sustainable system of commercial banking at the local level to extend credit at *commercial interest rate*. This made possible the transformation of BRI's unit *desa* system from merely a channeling agent for targeted subsidized Government's loans to a profitable financial intermediary providing loans and deposit services to clients in rural areas throughout the country. BRI-Unit Desa [BRI-UD] catered exclusively to micro and small customers in rural areas with the aim of operating it on a commercially viable basis without any support by means of subsidy from the Government. BRI-UD became profitable within few years of its transformation and established identity as a global leader in rural financial intermediation. It disbursed loans at interest rate sufficient to cover operational costs and also provide wide ranging financial services to the rural poor. It had considerable degree of autonomy for framing policy and operations from its parent concern, the BRI and was highly decentralized in its operations. High interest rate policy and high spreads between deposits and loans accompanied by BRI-UD's concern for customers had been the major factors, among others, attributed to its profitable operations. The BAAC, a Government owned institution in Thailand was also a successful example among rural agricultural finance institutions. It was established to provide credit exclusively to agriculture. It replaced the Bank of Cooperatives. BAAC provided credit both directly and through agricultural cooperatives and farmers' associations at interest rates below the market rate. However, since 1999, as part of efforts at reforming the Bank's interest rate policy, BAAC started to follow a policy of charging a minimum lending rate irrespective of the loan amount. Borrowers with good performance and track record were given preferential interest rates. Commercial banks that cannot achieve the minimum lending target of 20% of their total loans fixed for lending to agriculture were required to deposit their funds with BAAC and bear the administrative cost of maintaining these funds. Since 1999, BAAC had decentralized its banking operations and strengthened by substantially increasing the number of branches and field officers. Since 1999 each BAAC branch had been organized as a profit center and return on assets was considered a major yardstick to measure branch performance. Interestingly, its business portfolio predominantly comprised long-term loans and it had covered around 92% of total farm households in Thailand. In few years, it had diversified its operations to become a rural bank offering a host of services departing from its traditional role of an agricultural lending bank. Bank had put in place appropriate human resource management and training policy accompanied by its emphasis on financial sustainability and a robust MIS as critical ingredients of success. These two successful cases need to be now evaluated in the light of significant socio-economic & technological changes, among others.

Small farmers

Research on rural households showed that even small farmers and poor do save as has been evident from the experience of Self-Help-Groups and a large number of micro-finance borrowers in developing economies. Widespread use of informal credit revealed that even poor farmers with their own savings periodically borrow from informal sources at high effective rates of interest. They also maintain enduring relationship with moneylenders who provide timely access to small loans with ease. Given the risky nature of farming environment farmers are anxious to have access to a range of potential sources of finance even at high cost. Small farmers tend to be risk-averse and are conservative in their decision-making. They cope with risks by diversifying their household income from farm [mixed farming] and non-farm activities. They save in various forms, accumulate physical assets and participate in networks defined by social relations and mutual aid arrangements. Their cash flow often indicates existence of complex interdependency between the farm and the family household. Non-farm income accounts for a larger share in the household income. Governments in developing economies did not recognize the significance of sources of non-farm income while concentrating on increasing the food output. Consequently credit programs did not consider the effects of diversified and off-farm income generating activities on the overall farm household's net cash flow. Farmers' capability to meet part of credit needs out of their savings and their ability to repay, which included diversified sources of income, was underestimated. Accordingly, development and provision of appropriate savings/deposit facilities and diversified loan products should form essential components of RFI's strategies.

Thus, there is need to invest in R&D efforts both by the Government & scheduled commercial banks and successful RFIs should provide range of financial services to match the needs of existing as well as new rural clients and should also demonstrate their competitiveness with informal lenders, as informal financial markets/arrangements are important in the rural economy and they have continued to grow despite the presence of directed and subsidized credit. In the context of significant demand for rural credit as also bringing hitherto financially excluded rural households in the banking fold, the strategy should be how best informal credit markets can be integrated with formal financial markets and progressively their incidence minimized.

Informal sources

From time immemorial informal financial services providers fill the gaps in financial markets and make huge profits keeping poor in abysmal poverty. They serve predominantly lower income people who are perceived by formal financial institutions as "*unbankable"* as they are unable to comply with terms and conditions of loans including offering tangible collateral as security.. Besides, informal loans have distinct advantages over formal loans, viz. no restrictions imposed on the purpose of its use, provided in small amounts and with ease and in a minimum time. Informal lenders have their own borrower-friendly practices to overcome the high cost and risk barriers which formal financial institutions are yet not able to develop. Local feel, familiarity & in-depth knowledge of informal moneylenders in specified village ensures their clients convenience and timely access to credit. Their continued dialogue & familiarity with existing clients increase their better understanding of borrower's credit needs for a variety of purposes and loan repayment capacity and reduces the costs of loan follow-up. As rural clients/borrowers are interested in maintaining a good credit reputation to ensure continued access to credit resources, clients have a strong incentive to repay their loans promptly.

RFIs will need to put in R& D efforts to understand the dynamics of informal financial markets that can help them appreciate the distinct advantages that they offer. Informal lenders include moneylenders, input suppliers and traders. They lend for distinct purposes and offer credit on different terms and conditions to individuals based on their personal knowledge and past experiences. In African countries, there exist successful models of group-based credit arrangements in the form of rotating savings and credit associations. Rural Microfinance models in several countries of Asia, Latin America & Africa in last three decades have also been the successful efforts in this direction.

A single channel marketing system interlinking the supply of inputs [seeds, fertilizers] with credit and output marketing services helps small producers to receive inputs & services and lenders to receive repayments on time. However, where alternative marketing outlets exist, loan repayment may not be guaranteed. Recovery is difficult to enforce, as the farmer borrower may opt to sell his produce to another buyer. But in actual practice, a consideration that deters farmers from selling their produce to others is the fear that they would not be able to access to seasonal production credit for next crop season. It is also a fact that at the same time small farmers are paid unfair low prices for their produce in comparison with the costs of production inputs already supplied. They are disadvantaged by their weak bargaining position.

In a competitive market environment the agribusiness firms & value chain suppliers need to establish long-term relationships with farmers which itself is mutually beneficial. This relationship ensures a steady supply of primary raw materials or final products of better quality. The approach should emphasize to supplement credit with technical assistance on farming and strict production supervision by traders or agribusiness firms. Agro-processors can also find this approach profitable for agricultural commodities that require highly specialized processing facilities & those are to be exported..

Commercially Viable Financial Institutions

Rural financial market development includes the provision of both farm and non-farm credit [even consumption credit] as well as provision of savings/deposit services. This necessitates the establishment of commercially viable RFIs & creation of enabling environment to act as full-fledged financial intermediaries that can compete with informal lenders. When it lends to poor clients in rural areas it has to meet two performance criteria viz. *outreach* and *sustainability*.

Outreach

Outreach refers to the extent to which RFI provides better quality financial services to a large number of small clients. It includes both horizontal dimension of "*coverage"* that measures the number of clients that are served, as well as a vertical dimension of "*depth"* that refers to the income level profile of the assisted clients. It should evaluate the degree to which RFI assesses the *effective demand* for financial services of the targeted clients and develops appropriate financial products & marketing strategy to meet the demand. The concept of outreach includes *quantitative* and *qualitative* dimensions and is a dynamic one requiring periodical market surveys and efficient customer services.

Sustainability

A major aspect of sustainability is the financial self-sufficiency or the ability of the RFI to provide financial services on a cost-covering basis without depending on external subsidies. RFI can attain financial sustainability when the return on its equity [net of subsidies received] equals or exceeds the opportunity costs of capital. In other words it means that RFI must recover all the costs that include [i] cost of borrowed funds [ii] cost of loan administration [iii] prescribed level of provision for loan losses and [iv] costs of protection against inflation. RFIs are considered commercially viable when they generate profits above their total financial transaction costs and can finance the development costs that are required to provide new financial products from their retained earnings. It is possible that RFI cannot attain financial sustainability in the first one or two years of its operations but keeping this objective it should formulate a comprehensive business plan, develop strategic action plan and put in place effective monitoring mechanism to attain financial sustainability from the third year. While financial self-sufficiency is a pre-requisite to sustainability, other factors are also equally important viz. [i] development of new financial products to respond to market opportunities [ii] provision of better quality financial services to improve RFI's competitiveness in the market to earn client trust and loyalty. [iii] ability to access financial markets and find resources to fund growing loan portfolio and to strengthen the equity base of the RFI [iv] effective coordination among Government departments and other stakeholders seeking their cooperation for business development. [v]. good governance and efficient management structure that protects the RFI against anticipated political interference

Commercial banks

Commercial banks in some cases extended limited services to large agro-industries in rural areas but did not attempt to finance poor farmers.. This was the reason why Governments established State owned banks for farm financing. The structural adjustment programs, financial sector reforms and the changed environment of market liberalization and privatization affected these State owned banks, consequent upon which many of these banks have been restructured or have ceased their operations. Now it is most opportune time for commercial banks to enter into rural finance. In fact commercial banks are better suited for rural finance. They have professional staff, business acumen, rich experience of commercial business and better access to financial markets to tap resources. Their ability to mobilize & manage resources, aggressively market products and adopt sophisticated technology should motivate them voluntarily to establish need-based network of rural branches and develop specific financial services for the poor clientele. Well-functioning banks have institutional advantages for client coverage. They are able to provide full financial intermediation services and can offer a wide range of financial products through regulated contracts. They need to establish public image and earn confidence of their clients in order to compete with informal lenders, who can be costly but easily accessible and provide timely services. In particular, management of commercial banks as formal lenders need to demonstrate their concern and commitment to help country's rural poor and build a financially viable and sustainable RFI by reducing high costs and risks that are associated with farm financing through efficiency and application of technology and pass on savings in costs to rural poor clients.

III. RESULTS AND DISCUSSION

Initiatives to expand Rural Finance

Experiences suggest that rural finance has significant potential for expansion with the initiatives of the Government. The Government has to establish an enabling policy environment and lay down an appropriate legal and regulatory framework. In the event of serious market failures Government may consider to provide financial services directly. But as the available financial resources are limited, costly and having competing demand direct Government interventions should be limited and selective strictly based on operational efficiency and cost-effectiveness. Unanimously accepted view has been that the public sector banks should not have any kind of privileges that create unfair competition i.e. there should be perfect level playing field among RFIs of different ownership. Besides, Government's priority should focus on critical areas that help RFIs expand and attain sustainability viz. [i] to provide annually adequate financial and other resources to create basic rural infrastructure, such as irrigation facilities, roads covering all villages with important towns and cities, electricity, transport, information and communication technology, major marketing infrastructure etc. that can sustain smooth financing of agricultural and rural development programs [ii] to promote research in agriculture that can enhance farm productivity and minimize production costs and put in place effective extension services that can disseminate proven and demonstrated technology among farmers and facilitate farmers adopt it by securing credit facilities from RFIs [iii] to lay down an appropriate financial system development policy, which supports effective financial intermediation, reduce financial transaction costs, and increase the access of farmers to financial services, facilitates the use of appropriate loan collateral and develops a proper regulatory and supervisory framework for the different types of financial institutions [iv] to establish apex financial institution that can provide term lending facilities for investment purposes to eligible RFIs for on-lending to farmers, as RFIs would be able to mobilize rural savings/deposits that can be lent as short-term loans for crop production [v] to facilitate the operation of adequate risk management mechanisms such as crop, livestock & farm-asset insurance, loan guarantee and deposit insurance schemes which can be administered in a cost effective manner sharing experiences on best practices with other countries. [vi] learning from the past the Government should refrain completely from intervening [a]directly in granting loans to farmers, fixing credit targets, directing credit to targeted users and for targeted purposes, setting interest rates, postponing loan recovery as also outstanding loan/interest waivers and write offs [b] in the human resources development and business policies of RFIs [c] in the operational autonomy and management of RFIs. All these should enable RFIs to develop themselves as operationally viable and financially sustainable institutions to dedicate to the services of farmers in general and small and poor ones in particular.

International donors can contribute to Government's initiatives in respect of [i] creating and fostering a proper enabling environment [ii]improving the financial infrastructure[iii]building institutional capacity of RFIs and [iv] strengthening the capacity of rural clientele to access financial services.

The multilateral financial institutions and international donors have acknowledged the significance of RF as an essential component of development finance in their unflinching efforts to significantly reduce rural poverty, hunger and children & pregnant women's malnutrition through building financial, social and human assets of low-income individuals and communities. They pledge to enhance the ability of low-income people to create, control, and maintain financial assets, such as savings, investments and the equity in their homes and enterprises. There is a general consensus among them on the issues that make RFIs most successful. They insist on developing RFIs that are autonomous; are rural-based, but not specialized only in agriculture; charge market interest rates; engage in true financial intermediation by mobilizing savings; reduce reliance on donor or State funds; maintain quality of the portfolio and record fewer loan losses; and retain superior quality staff through staff incentives.

In short, a radical change from 'supply-led credit to demand-driven credit' had long been advocated by a few policy interventionists at international level. The new approach has now gradually been accepted in most counties, except a few countries for best known reasons. The new approach focuses basically on accelerating the process of agricultural and rural development, asset creation, income expansion and poverty reduction by using credit as a catalytic and lubricating agent. They, also, recognize that RF may not always be provided in a cost-effective way in all geographical regions that include arid, semi-arid, drought prone, tribal and hilly areas to accomplish these goals and that effective RF intermediation should often be complemented by the Government's committed actions viz. increased investment in rural infrastructure, disaster management and in human development. The new approach proposes an active role of the Government in establishing favorable policy environment to facilitate the smooth functioning of Rural Financial Markets [RFMs] and RFIs , but a more limited role in direct interventions in RFMs and RFIs such that they cannot distort RFMs and vitiate credit culture and discipline..

Need for: Studies in India reveal that [i] agricultural credit disbursements in absolute terms have been substantially increasing year after year in order to achieve/surpass the agricultural credit targets announced in the annual budget by the Union Finance Minister whereas none of the banks has been achieving 18% credit targets, 13.5% direct credit targets & 7% credit targets to small farmers, among others [ii] there has been total mismatch between planning & disbursement of short-term & long-term investment credit as investment credit has been significantly less than what is required to keep pace with disbursement of short –term loans.

This approach followed since 1982 has,also, created certain pernicious problems, viz. [i] Banking & credit policy has been uniform [one-size-fits-all] for the entire country despite India has several distinct agro-ecological regions & sub-regions [ii]Banks could not utilize the expertise of their professionally qualified/technical personnel to assess credit absorption capacity of farmers & area-wise effective demand for credit for agriculture, develop credit products, formulate marketing strategy, periodically evaluate the impact of credit on productivity of crops, refine the lending procedure, effectively coordinate with Government officials to review/monitor the implementation of agricultural development programs, identify shortcomings & improve the policy & implementation, capacity building & skill improvement training to farmers etc. Instead they put vigorous efforts to achieve the targets announced by the Union Finance Minister. Their professional initiatives & creativity have been lost. Resultant effect of this has been that now banks have accorded low priority to recruit technical personnel & place non-technical personnel in rural branches.[iii] Loan utilization by farmers is not supervised which has resulted into substantial amount of over dues ultimately building up huge amount of non-performing assets [iv] Capital subsidy linked with credit under a number of agricultural development programs & Interest subvention scheme have been utilized for purposes other than intended.

Despite huge amount of credit disbursed, it has not reflected/translated in harnessing even 50% potential of crop/livestock/fish production when technology is already available because efforts to create simultaneously enabling environment for conducive development & growth of agriculture fell short particularly in respect of [i] public investment in agriculture in R&D, irrigation, farm power, processing, storage, transport & communication, marketing & physical infrastructure [ii] significantly improving the effectiveness of farm extension services to create awareness among small & marginal farmers & ensuring that they adopt modern scientific technology and minimize the existing 30% yield gap between the actual yields at farmer's level & yields on demonstration farms under existing level of technology [iii]motivating, encouraging & incentivizing a large number of small & marginal farmers to use seeds of high yielding varieties/hybrids instead their own farm saved seeds [iv] ensuring the quality. price & on time availability of fertilizers, farm equipment, electricity/diesel [v] amendment to important legal provisions of the Agricultural Produce Market Committee Act which have proved detrimental to farmers' interest [vi] pro-farmer crop & livestock and farm assets insurance scheme & its efficient administration [vii] reinventing the policy on procurement, storage & distribution of food grains i.e. Minimum Support Price, Food Corporation of India & Public Distribution System

IV. CONCLUSION

It is now opportune time to revisit the agricultural/rural banking & credit policy that has been evolved from time to time sharply stipulating targeted/supply-led credit since 1982 in respect of each component through independent evaluation studies in the light of significant changes Indian economy has witnessed during post-reform era & presenting opportunities to bring metamorphic transformation in agricultural production system and address chronic problems of rural poverty, hunger, malnutrition & under nourishment of children, food & nutritional security, livelihood of small, marginal & tenant farmers, oral lessee, share croppers and those residing in desert, drought-prone, hilly & tribal areas and more importantly attracting rural youths in agriculture.

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