Rural Credit in Karnataka: Systemic Weaknesses and Corrections

B.N. Kulkarni, B.Jayaraman and R S Deshpande *

Introduction

The rural credit system in India has gone through critical reviews by various Committees[1]. Many of the recommendations by these Committees and the RBI/GoI for improving the financial health and efficiency of the rural credit institutions have been accepted and subsequently implemented. Committee to Review Arrangements for Institutional Credit for Agriculture and Rural development (1979), resulted in the formation of NABARD (1982) and the on-going financial sector reforms since 1991. Further, several initiatives like Kisan Credit Card, Special Agricultural Credit Plans, RIDF Scheme, etc., are put in place to increase the coverage and flow of institutional credit to agriculture sector. An important development in this regard is the phenomenal growth of Self-Help Groups, a concept promoted and nurtured by NABARD since 1990 and now acknowledged as the World's largest poverty alleviation programme through micro-finance.

Despite all these initiatives, issues like the distribution of credit across sectors and classes of farmers, access to credit, cost of credit across different uses and, finally, the credit delivery system continue to remain high on the agenda of banking reforms. These problems came under sharp focus specifically in the context of farmers' distress and the recent spate of suicides of farmers in the country. Among the States in India, Karnataka had a large share of suicide cases and it was blamed on the credit (Deshpande, 2002, Vasavi, 2001). Karnataka is also at the bottom in terms of share of credit for agricultural sector. Therefore, the access to (institutional and non-institutional) credit coupled with the poor recovery of loans, especially, in the co-operative sector accentuating the inability of these banks to effectively recycle their funds to the agricultural sector is one of the reasons cited for farmers' distress is r. The present paper is an attempt to assess the performance of the banks in the state in purveying rural credit in the State and to analyse the factors contributing to such performances.

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* Authors are General Managers, NABARD, HO, Mumbai, and Professor, ISEC, Bangalore respectively. The views expressed in this paper are personal views of the authors and have no bearing on the Institutions of their affiliation.

Credit Policies: Tracing the Path

Hitherto the overall thrust of the credit policy has been aimed at direct action of the State, in particular with the rural branch network of co-operatives and banks in rural areas. New financial institutions like RRBs in partnership with the State government and Commercial Banks were introduced to step up the flow rural credit and accelerate the pace of capital formation in the private sector so as to achieve capital formation and stability in the agricultural production. The share of non-institutional agencies in the outstanding cash dues of rural households was reduced from 84% in 1961 to 39% in 1991. The formal credit sector underwent a gradual change after the 1990s with the Government announcing the first nation wide Agricultural Rural Debt Relief (ARDR) Scheme, a *loan pardon scheme* in 1990. This emerged as an important turning point that witnessed the slowing down of the credit disbursement by the formal credit institutions. The ultimate impact was on the poor and weaker sections rural society. That paved way for the growth of the informal institutions like the SHGs and the micro-finance institutions (MFIs) like SHARE, BASIX, Co-operative Development Foundation, etc along with the increased presence of money-lenders. The formal credit in rural areas declined on account of the loan waiver scheme, the largest institutional cluster to be affected being the Co-operatives. The share of direct agricultural credit[2] disbursed by Public Sector Commercial Banks also declined from 15.3 per cent in 1991 to 11 per cent in 1998 and further down to 9.8 per cent in 2002 but marginally rose to 11.08 per cent during 2004. The credit to GDP ratio for the agriculture sector during 2001-02 at 11.1 % was the same as during 1985-86, with a dip to 9.3 % during 1993-94 coinciding with the financial sector reforms. With the opening of the economy, RRBs and Co-operative banks were allowed complete *freedom on the rates of interest*, while in the commercial banking sector, Small Borrowal Accounts (SBA) for agriculture were not allowed to charge interest rates greater than the Prime Lending Rates (PLR). This policy proved to be a disincentive to the Commercial Banks for increasing the density of rural credit. Initiative for restructuring the RRBs have had a positive impact on the financial health of these institutions and the new emerging private sector promoted initiatives of Local Area Banks were encouraged but that met only with a limited success. The recent policy initiatives highlight the importance of SHGs in rural financial systems and Apex Level institutions like the NABARD and the Small Industries Development Bank of India (SIDBI) have made foray into the micro-finance sector and in the past few years *micro finance* is getting mainstreamed into the banking sector.

The Government of India announced, in June 2004, a package to double the credit to agriculture in three years. It had envisaged 30 per cent growth in credit flow in 2004-05, with the year 2003-04 as the base year, with specified shares for Commercial Banks, Regional Rural Banks and Cooperative Banks. Other components of the package included Financing of at least 100 new farmers by each semi-urban and rural branch during 2004-05, financing of at least 2 to 3 new investment projects by each branch in plantation and horticulture, fisheries, organic farming, etc., financing at least 10 Agro clinics in each district during 2004-05, providing credit to tenant farmers and oral lessees and debt restructuring for farmers in distress and/or arrears.

AGRICULTURAL CREDIT SCENARIO IN KARNATAKA

Credit policy in India is aimed at expanding the coverage of financial institutions – Co-operatives as well as Commercial Banks, including Regional Rural Banks – and using credit as a means of rural development and poverty alleviation. This naturally became the theme of the structure of banking in the country. The network of credit institutions in Karnataka includes – Commercial banks (44), Regional Rural Banks (13), Karnataka State Apex Co-operative Bank (KSCAB), District Central Co-operative Banks (DCCBs - 21), Karnataka State Co-operative Agriculture and Rural Development Bank (KSCARDB) and the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs - 177). In addition to the formal institutional credit network in the State, a number of informal institutions have cropped up. There are as many as 470 NGOs, which are actively involved not only in the field of micro-credit and performing the role of Self-Help Promoting Institutions but also in promoting entrepreneurship for rural non-farm sector activities. In addition to these, there are a good number of organisations involved in other community development programmes, which help in effectively supplementing the efforts of the institutional network.

In Karnataka as on March 2004, 5697 branches of various financial institutions are functioning, of which as many as 2699 (47%) branches are in rural areas. The number of branches has gone up marginally as compared to 5534 branches in 2003. A marginal increase in the number of branches in rural areas from 2733 in 2001 to 2699 in 2004, was noted. The number of semi-urban and urban areas has also registered a similar increase. Average population served per bank branch in the State improved to 9528 in 2003 from 16,000 in 1975 (Table 1). Aggregate outstanding deposits registered a growth of more than 21 per cent in 2004 (Rs. 77,693 crore) over 2003 (Rs. 63,840 crore), the share of urban and metropolitan areas being around 71 per cent. Outstanding advances recorded an increase of over 24 per cent in 2004, compared to the previous year with the metro branches accounting for more than half (55%) of the share of the total loans. Credit-Deposit Ratio stood at 66.44 per cent in 2004 as against 65.15per cent in 2003 (Table 2). Agency-wise analysis indicates that the RRBs have higher CD ratio (83.20%) than the Commercial Banks (65.65%).

Table 1: Banking Network in Karnataka

Particulars	March 2002	March 2003	March 2004	March 2005
No. of Branches	5553	5534		
Rural	2671	2653		
Semi-Urban$	1137	1151		
Urban	927	939		
Metro Town	818	791		
Per Br. Population	9495	9528		

Source : Various SLBC reports

Table 2: Mobilisation and Deployment of Resources - Karnataka: 2002 - 03

(Rs. Crore)

	Rural	Semi-Urban	Urban	Metro	Total
Deposits *	8812	11010	13678	30340	63840
Advances *	6624	6054	6899	22014	41592
CD Ratio	75.17	54.98	50.44	72.56	65.15

Source : Various SLBC reports* CBs and RRBs

Performance of Banks in Karnataka

An analysis of the Ground Level Credit (GLC) disbursed by the banks during the five year period 2000-01 to 2004-05 indicated that although in absolute terms the GLC had been showing a positive growth, the achievement as a percentage of the target was between 90-94 per cent till 2002-03 but during the years 2003-04 and 2004-05, the achievements was in excess of the targets by 8 and ----- (This needs to be filled from the SLBC data) basis points, respectively (Table 3). The GLC for crop loans has been markedly better, with the achievements exceeding the targets in all the years, excepting during the years 2002-03 and 2003-04 mainly due to the continued drought conditions prevailing in the State. An area of concern is the under performance of the credit institutions in respect of term loans for agriculture. During the period of analysis, the achievement as per cent of the target ranged between 64 during 2001-02 and 88 during

2002-03 (Table 4). While drought continuous drought in many parts of the State be a probable reason for the under performance, the need for improving the credit absorption capacity in the rural areas of the through improvement in agricultural related infrastructure, including extension and marketing, the two weak areas cannot be undermined. Another area of concern is the decline in the relative share of GLC over the years, both under crop loans and term loans. The relative share of the co-operatives under the crop loans has come down from nearly 37 per cent during 2000-01 to 21 per cent by the year 2004-05 while for term loans it's share had declined from 25 per cent to 8 per cent during the corresponding period. The decline in the share of the co-operatives could be attributed to their poor financial, accentuated by the drought and the policy announcements of the Government on interest waiver and recovery of loans by the co-operative banks. Credit flow for Other Priority Sectors increased nearly 3.9 times over the level of 1998-99 and the flow to Non-farm Sector also showed a growth of 34% over the previous year (Table 5).

Table 3:Crop Loans Disbursed by Various Banks in Karnataka

(Rs. crores)

Agency	2000-01	2001-02	2002-03	2003-04	2004-05*
Commercial Banks	1233.49 (44.30)	1360.56 (42.49)	1429.12 (46.55)	1629.03 (47.48)	1735.79 (53.75)
Co-operatives	1029.95 (36.99)	1233.54 (38.52)	1019.60 (33.21)	1110.21 (32.36)	682.13 (21.12)
RRBs	520.83 (18.71)	608.08 (18.99)	619.44 (20.18)	691.44 (20.16)	811.40 (25.13)
Total	2784.27 (100.0)	3202.18 (100.0)	3070.23 (100.0)	3431.29 (100.00)	3229.32 (100.00)

Note: Figures in parentheses are percentages to total
* As on 31 December 2004
Source : Various SLBC reports

Table 4:Term Loans Distributed by Various Agencies in Karnataka

(Rs. crores)

Agency	2000-01	2001-02	2002-03	2003-04	2004-05*
Commercial Banks	507.29 (64.25)	450.49 (73.08)	620.34 (72.17)	826.71 (78.45)	720.14 (78.20)
Co-operatives	197.08 (24.96)	165.94 (26.92)	239.23 (27.83)	118.65 (11.26)	71.58 (7.77)
RRBs	85.24 (10.80)	83.58 (13.56)	107.45 (12.50)	107.56 (10.21)	129.08 (14.01)
Total	789.61 (100.00)	616.43 (100.00)	859.57 (100.00)	1053.75$ (100.00)	920.95$ (100.00)

Note: Figures in parentheses are percentages to total. * As on 31 December 2004
$ includes Rs. 0.83 crore and Rs.0.15 crore, respectively, disbursed by other agencies.
Source : Various SLBC reports.

Viewed against the target of Rs. 6253.14 crores under the package, the performance of the banks in Karnataka by way of over achievement (Rs. 7557.30 crores – 113 %) has been good, except for the DCCBs, which had achieved only 81 per cent of the target. The CBs and RRBs had performed well in financing of new farmers. While the RRBs had financed 1,49,620 new farmers, surpassing their target of financing 1,05,200 new farmers, the commercial banks have financed 2,05,564 new farmers against the target of 2,14,400 (96% achievement). It is expected that by 31 March 2005, they would have achieved the target. The DCCBs have financed 39,833 new farmers (96%) as against 41,624. The RRBs have also performed exceedingly well by financing 18,172 new investment projects against a target of 3156. As regards financing of agri-clinics, against a target of 270 agri-clinics in the State, the CBs and RRBs had financed 113 agri-clinics in the State up to 31 March 2005. The co-operative credit structures, however, have financed only one agri-clinic in the State. The combined achievement was only 42 per cent of the target.

Table 5: Advances to Non-Farm Sector and Other Priority Sectors

(Rs. crore)

Agency	2000-01	2001-02	2002-03	2003-04	2004-05*
Commercial Banks	1317.40 (79.14)	1482.41 (78.00)	2233.64 (81.23)	3699.55 (83.17)	2985.20 (82.08)
Co-operatives	90.82 (5.46)	159.26 (8.38)	222.77 (8.10)	181.29 (4.08)	225.69 (6.21)
RRBs	256.33 (15.40)	258.83 (13.62)	293.29 (10.67)	386.28 (8.68)	312.56 (8.59)
Total	1664.56 (100.00)	1900.50 (100.00)	2749.70 (100.00)	4448.2$ (100.00)	3636.82$ (100.00)

Note: Figures in parentheses are percentages to total
* Provisional $ includes Rs. 181.08 crore and Rs.113.37, respectivelydisbursed by other agencies
Source : Various SLBC reports.

Financial Health of rural Credit Institutions

The SCB has been continuously posting profits during the past five years with moderate growth in other areas and the NPA as percentage of the loans outstanding stood at 12 % as at end March 2004. The non-receipt of interest, consequent to the loan waiver in Kharif 2002, affected the level of their NPAs due to a slide in the aggregate recovery rates, reflecting on the financial health of the DCCBs and resulted in many of them incurring losses during 2002-03. The number of DCCBs (10) registering accumulated losses in 2003 was more than that in 2001-02. However the number of DCCBs in profit increased to 14 by March 2004. As on March 2004, four out of the 21 DCCBs were not in a position to comply with the minimum share capital requirement as laid down under the provisions of Section 11 of the B.R.Act (AACS), 1949. In the case of PACS, in spite of an increase in their number from 4396 to 4473 between 2002 and 2003 and a growth in the mobilisation of their deposits and recovery rates, the number recording profits shrunk from 1915 to 1719 in 2002-03, whereas those incurring losses and accumulated losses recorded an increase.

The financial position of the LT Co-operative Credit Structure (KSCARDB and PCARDBs) has been deteriorating due to a host of both internal and external factors and also due to the frequent announcement of loan waivers by the government, which in turn has adversely impacted the ability of these institutions to affect recoveries from the borrowers. The recovery position of the SCARDB and the PCARDBs was only about 17 per cent while the NPAs as per cent to total loans outstanding was as high as 48 per cent by March 2004. This obviously affects the flow of credit for capital formation. The performance of RRBs during 2003-04 was satisfactory, registering a growth of 9% in the amount of deposits outstanding, a modest growth of 4% in the credit outreach, 83.20% CD ratio as against 77.58% in 2002-03 and a jump in the net profits from Rs. 70.51 crores in 2001-02 to Rs. 104.47 crore in 2003-04.

Role of NABARD in the State

The performance of NABARD in terms of refinance disbursements (Table 6) has been good despite the continuous drought in the State for the last three years. An important role played by NABARD in pursuance of its commitment to rural development, but rarely acknowledged, is the promotional and institutional development, especially for co-operative banks and RRBs. NABARD has also played an major role in partnership with its client institutions in ensuring the success of SHG movement in the State (including Stree Shakthi). The Bank has also taken initiatives in preparing the Potential Linked

Credit Plans (PLPs), Area Development Plans for specific activities/investments and in sensitizing the stakeholders in agriculture and rural development in the State. The Farmer's Clubs, numbering about 1900 in the State, promoted by various banks and NGOs under the Vikas Volunteer Vahini Programme, have also propogated the message of Development through Credit. In promoting the Rural Non-farm Sector activities and in building up the entrepreneurial skills of the people, NABARD has integrated the farm and non-farm sector to provide off-farm employment and supplement their income.

Table 6: NABARD's Agency-wise Refinance disbursed

(Rs.crore)

Agency	2000-01	2001-02	2002-03	2003-04
Commercial Banks	138.63	48.60	66.69	131.01
RRBs	363.54	382.75	369.55	343.78
KSCAB	590.53	665.14	776.79	746.59
KSCARDB	125.12	113.93	114.16	80.00
PUCB	0.00	7.15	1.10	0.00
Total	**1217.82**	**1217.57**	**1328.29**	**1301.38**

Regional Imbalances in Credit Flow

(It will be appropriate to give the basis for classifying the various categories) It is quite intriguing to observe that the share of highly developed districts in the total agricultural credit ranges from 23.1 per cent to 30 per cent across the sub-periods and that has remained consistently high. For developed category of districts, the share of agricultural credit, on an average, varied in the range of 34.8 per cent to 37.6 per cent. Unfortunately the backward and highly backward categories of districts have remained at the bottom in terms of the share of agricultural credit. It is quite obvious that the major share of the credit goes to developed regions as these regions have a better credit absorption capacity can service the credit effectively as also offer the required credit guarantee. It is essential to apply the principle of cross subsidy and provide higher amount of credit to the backward regions at a lower interest rates, at least in the initial stages but at the same time equally important, if not more, is the need to explore the technological options available and to develop the infrastructure that could release the locked up resources and enhance the credit absorption capacity of these regions.

Table7: Type of District-wise Share (%) of Agricultural Credit Given by SCBs

Type of Districts	Average for the period of 1981-85	Average for the period of 1986-90	Average for the period of 1991-95	Average for the period of 1996-2000

Highly developed	30,0	29,7	26,3	23,1
Developed	34,8	34,9	37,0	37,6
Backward	20,0	21,0	20,2	20,5
Highly backward	15,2	14,4	16,5	18,7
All	100 (5,615,452)	100 (13,636,697)	100 (20,566,529)	100 (38,561,472)

Note: Figures in parentheses represent mean agricultural credit (Rs. in thousands) for each period.

Source: Derived from Reserve Bank of India (various issues of *Banking Statistics* starting from the years 1981 to 2000) Rajasekher and GB Sahu, Submission for Karnataka Development Report, ISEC, Bangalore.

Developments in Credit Co-operatives

The recommendations of the *All India Rural Credit Survey Committee–(under the Chairmanship of Gorewala) in 1954,* focused on Development of Co-operatives as the most suitable agency for rural areas with the State government contributing to their share capital for partnering their development as well as integrating co-operative credit with co-operative marketing and processing. Coinciding with the country's liberalisation process in 1991-92, steps were initiated to consolidate the expansionary process by emphasising on the viability and operational efficiency in rural credit operations, based on the recommendations of a *Committee on Financial Systems (under the Chairmanship of Shri. M. Narasimham).* This resulted in application of widely accepted prudential norms on income recognition, asset classification and provisioning, initially on Commercial Banks and later to RRBs and Co-operatives with the deregulation of interest. But, this period was also marked by a decline in the credit-deposit ratio of the rural branches of commercial banks and the RRBs indicating an undesirable shift of resources from rural area to safe non-rural investment channels, mostly gilts. Hence, limited success could be achieved in the post-liberalisation period and the quest for measures to reform the rural credit system continued, especially against the backdrop of the weakening of the co-operative credit institutions. This demand was met by appointing the Capoor Committee in 1999 by the RBI to study the functioning of co-operative credit system and suggest measures for its strengthening and the Expert Committee on Rural Credit (ECRC) under the Chairmanship of Prof. Vyas by NABARD in 2000 to review the emerging scenario in rural credit and preparation of workable comprehensive plan of action for a more effective rural credit. The *Capoor Committee (2000)* appointed by RBI, suggested measures for strengthening of the rural co-operative credit institutions. It also recommended maximum autonomy and strengthening of the member-driven co-operatives with greater transparency. The Committee also stressed the strengthening of the resource base, especially capital and recommended structural changes including development of the infrastructure of the PACs and PCARDBs with substantial improvement in management of human resources. The *Vyas Committee, in its Report submitted in 2001,* recommended for Government financial support; the need for replacing State Co-operatives Act by the Model Act so as to achieve effective co-operative governance; fuller applicability of B R Act,1949 to Co-operative banks; steps to strengthen PACS; promoting SHGs as co-operatives within co-operatives; reforming deposit insurance as per recommendations of RBI Committee of 1999; select de-layering of co-operative credit system; integration of long-term and short-term structures; and relaxation of norms for refinance support for co-operatives.

In 2004, the RBI appointed an Advisory Committee on Flow of Agricultural Credit (*Vyas Committee). Among the Terms of Reference for the Committee were t*o assess the progress made in implementation of the recommendations of the ECRC; to suggest measures to reduce the rate of interest on agriculture credit given by Commercial, Cooperative and Regional Rural Banks; to examine the role of NABARD; to study the role and effectiveness of the RIDF mechanism and suggest ways to improve the same, or to suggest alternatives, with a view to increase direct agriculture lending; to identify the impediments in the flow of credit to the disadvantaged sections such as small and marginal farmers, tenant farmers, oral lessees and landless labourers and suggest measures to be taken by banks for providing financial assistance to them; to suggest short-term and medium-term measures to improve the flow of credit to agriculture; to study the role of micro finance in poverty alleviation and adoption of the Self Help Group (SHG) approach in extending banks' outreach to the disadvantaged sectors; to examine the need to regulate micro finance institutions and to suggest appropriate regulatory model and to examine the norms relating to NPAs in cases of crop failure where seasonality and uncertainty are not captured.

Some of the important recommendations made by the Committee on increasing the flow of credit to the agriculture sector are:

a. The existing target of 18 per cent of net bank credit for lending to agriculture may continue;

b. The system of Special Agricultural Credit Plan (SACP) may be continued and may also be made applicable to private sector banks;

c. The share of small and marginal farmers in agricultural credit should be commensurate with their holdings and credit needs and, therefore, credit to small and marginal farmers should be progressively raised to 40 per cent of disbursements under the Special Agricultural Credit Plan (SACP) by the end of the Tenth Plan period;

d. State Governments may consider reducing the stamp duty and bringing it at par with the one charged to cooperative banks;

e. If the three tiers in the co-operative structure do not contribute to the improvement in efficiency and ultimate reduction in cost of credit to the borrower, one of the tiers could be considered for elimination;

f. Contract farming is another private mechanism that helps the farmers to cope with private risk as it provides a guarantee of buy back of the produce from the farmers at a predetermined price and transfer the market risk to the contractors;

g. Setting up of an "Agri-Risk Fund" with equal contribution from the Central and State Governments and the participating banks. Such a fund would mitigate risk of the lending banks as they can have recourse to the fund in the event of genuine default and it would also mitigate the hardships of the farmers;

h. Banks should provide a separate flexible revolving credit limit to the small borrowers of production or investment loans for meeting their temporary shortfalls in family cash flow. Banks may evolve suitable credit products / packages in this regard; and

i. A branch advisory committee comprising select elected representatives of the local PRIs hailing from the service area of a branch, which may include women leaders of PRIs , may be established at every rural branch which should meet at least once in a quarter. These meetings may be made mandatory and must be attended by the controlling official of the bank.

Recent Developments in Agricultural Credit:

The State Budget for the year 2004-05 also provides relief to the farmers by way of reduced interest rates. Agricultural credit through cooperatives is to be made available at 6 per cent rate of interest for which an amount of Rs. 60 crore is provided in the budget for meeting the difference in the cost of loans to the banks and the interest being paid by the farmers. Some of the other important proposals are waiver of loans where the interest paid exceeds the principal amount (*damdupatta*) ; provision for waiver of interest on crop loans; raising the contribution of the Government to the the corpus of the Price Stabilisation Fund up to Rs. 100 crore; a comprehensive programme for the development of dry land on watershed basis will be launched in the current year and Rs.100 crore has been set apart for this programme and Plan outlay on agriculture enhanced from Rs. 412 Crore in 2003-04 to Rs. 840 crore in 2004-05, up by 104%.

Constraints: Are these Formidable?

Changes over time, in the inter agency shares in the credit disbursement is yet another noteworthy feature. The present trend indicates that in view of the structural weaknesses of cooperative banks in the state and the limited presence of RRBs, commercial Banks will have to increasingly shoulder the responsibility of supporting private investment in agriculture. At the same time cooperative banks would need to be appropriately strengthened.

In the Investment Scenario

Major factors constraining growth in investment and thereby the flow of credit include:

i. Meager growth in minor irrigation and farm mechanization, which are the major sub sectors in agriculture;
ii. Declining public sector investment adversely affects enabling infrastructure;
iii. Lack of effective mechanism for technology transfer; poor extension services;
iv. Limited infrastructure for processing, value addition and marketing;
v. Restrictions on purchases outside the mandi;
vi. Inadequate linkages between spot and future markets;
vii. Lack of established Warehouse Receipt System etc.; and
viii. Presence of imperfect markets for agriculture.

Besides, the flow of credit to agriculture is constrained by a large number of factors such as institutional, real resource constraint, inadequate infrastructure and market restrictions. Particularly in the institutional constraints, the following factors affect the banking institutions in deployment of investment credit.

i. High Transaction cost of credit dispensation
ii. Limited outreach
iii. Absence of credit history of the borrower,
iv. Issues related to credit worthiness: Collateral – for low asset base farmers
v. Low volume of loans associated with high risk.
vi. High manual intervention/branch centric

In any scheme of things for enhancing credit flow to agriculture; these constraints will have to be addressed first.

Towards Future

- It is necessary to revisit and rationalize the figure of 18 percent of net bank credit to agricultural sector.
- The Vyas Committee expressed that the share of small and marginal farmers in agricultural credit should be commensurate with their holdings and credit needs. This needs to be looked into seriously. Credit to small and marginal farmers should be progressively raised to 40 per cent of disbursements under the Special Agricultural Credit Plan (SACP) of the commercial banks by the end of the Tenth Plan period.
- It is essential to integrate investment credit and production credit that will help in enhancing the private capital formation.
- Considering the new development in technologies scale of Finance needs to be increased. It is also necessary that the collateral issue is revisited keeping in view the property structure and land records in the rural areas. Recent credit policy of RBI prescribes loans upto Rs. 50,000 to be collateral free which the banks should implement in the true letter and spirit. The focus of the branch managers should shift from dependence on "Collateral Security" to "Creditworthiness" of the borrower and the " bankability of the investment/activity.
- Pledge financing, credit for marketing and introduction of Negotiable Warehousing Receipt System is required for enhancing the flow of credit
- Public investment in land rejuvenation, irrigation and better water management needs to be enhanced. The Union Budget of 2004-05 has stressed on these aspects and has introduced a new scheme for water harvesting structures.
- There is need for a long term plan to develop and bring waste and fallow land resources under productive use.
- Drought situation prevails in one or other part of the state. Therefore the schemes like (i) micro irrigation (ii) sprinkler irrigation (iii) watershed management (iv) village ponds development (v) farm ponds promotion (vi) dry land farming needs priority in lending policy.

The conversion and restructuring of farm loans should be done at reasonable rates of interest. Applying this logic in the case of restructuring of agricultural loans, banks need to fix the rate of interest on restructured loans at a level lower than the original loan. As per the directives of the GoI/RBI, banks are expected to charge an interest of nine per cent per annum on all agricultural loans but in practice the co-operative credit institutions in the State are, at present charging the farmers 12.5% for crop loans and 13.5% for long term loans in alignment with their cost of funds, cost of transactions of loans and high risk cost. The target for lending of agricultural loans for the co-operative bank during the year 2004-05 is Rs. 1598 crore, comprising of Rs.1477 crore as crop loans and Rs. 121 crore as term loans, under the programme of doubling of credit. The budget provision of Rs. 60 crore will suffice to cover loans amounting to Rs. 2,000 crore, assuming that the co-operative banks are charging nine per cent from the farmers and the amount will cover the interest difference of three per cent (9%-6%). This will enable the banks to just cover their costs and not facilitate to generate profits. However, when viewed against the ground level situation of the banks charging 12.5 per cent for crop loans, the budgetary provision that will be required for this purpose is Rs. 96 crore (Rs. 1447 crore *6.50%) while for term loans, the required budgetary provision is Rs. 9 crore (Rs. 121 crore* 7.50%). The total budgetary provision to cover the loss in interest of banks when they charge at six per cent should have been Rs. 105 crore. Thus, there is a shortfall of Rs. 45 crore. Such subsidization of one institution/agency in the field of rural credit also raises the important issue of providing a level playing field to other agencies purveying agricultural credit, especially for the RRBs, and also whether the co-operative agencies will be able to cater to the increased demand from farmers, who could switch over due to the interest differential between the co-operative and commercial banking sectors. Of course, the extent of switching from commercial banks, including the RRBs, to co-operative banks will also depend on the perceived trade-off between the reduction in the interest rate and the customer loyalty and the quality of service between the two agencies. What is important is a targeted interest rate subsidy that will benefit the small and marginal farmers rather than an across the board subsidy.

The Vyas committee has recommended setting up of an "Agri-Risk Fund" with equal contribution from the Central and State Governments and the participating banks

Hi-tech agriculture and precision farming are emerging sunrise sectors and this needs a boost in the form of investment. Only a few commercial banks have lent to high technology and capital intensive export oriented agricultural projects in the recent past.

Similarly to step up the capital formation in Agriculture increased Credit for Farm Mechanisation is required. With the emphasis shifting to financing of the value chain, there is also a need for stepping up of pledge financing, credit for marketing and introduction of Negotiable Warehousing Receipt System.

In addition to the above points it is essential to look back into the performance of the lead banking schemes and the area approach towards banking. Number of studies has shown that achievements on these two counts are not exemplary. Vyas committee has recommended that RBI should review the lead bank concept in view of changes taking place in the banking sector. Essentially, there is a wide gap between the *a priori* expectations and the results. From another view point, the organizational structure of rural banking requires to be reviewed theoretically in terms of access to credit and credit management policies. It has been said time and again that the presence of informal money market in rural areas thrives because of the difficulty in access to credit. That indirectly points towards the organizational innovations to re-examine procedures of recovery and legal provisions in the process of recovery. Credit information tracking and sharing through establishing a Credit Bureau enables lenders to provide incentives to those with good credit history and provides a strong deterrent to willful default.

There are strong arguments about the process of recovery and the Non-Performing Assets between rural sector and the industrial sector, especially defending the position of the rural sector. The norms of Non-Performing Assets (NPAs) in these two broad sectors have been quite different and often the NPAs of rural sector are highlighted in order to justify the shrinking flow of credit to rural areas and specifically to agriculture. Therefore, one needs to re-examine the NPAs from the standpoint of value addition in the sector. It is also essential to think the re-phasing as a strong credit management policy in rural sector.

One also wonders, the theoretical understanding of the cost of credit across sectors. It is essential here to underscore the fact that cost of credit and value addition due to credit in agriculture (rural in general) as against the non-agricultural sector is quite different. This argument does not restrict necessarily to the theoretical debate but also empirically it can be proved that the cost of credit and its relation to the value addition across sectors differ widely. Therefore, one wonders the equivalence cost of credit across sectors when in the recent past, banking industry has been varying credit norms for various activities depending on the returns from the activities.

The credit delivery system in the rural credit has been one of the important problems but the flow of credit has to go through a large number of impediments when it comes to disadvantaged sections. It has been reiterated many a times that the disadvantaged sections and especially the tenant farmers have significant amount of difficulties in approaching the credit institutions and their access to credit is not as smooth as the others. In Karnataka, as we have a legal ban on tenancy, it has become too difficult for the tenants to obtain credits in the absence of any documents. This needs to be looked seriously from the land policy point of view. In the recent past, contract farming has been emerging so also the hi-tech horticultural credit economy. These two sectors require larger credit inputs and have better value addition. But the economics of horticulture, floriculture as well as contract farming works differently than the usual credit loan system and therefore, it is required that the credit policy is tuned to the requirements of these sectors specifically.

During the last decade, Self-Help Groups (SHGs), Non-Governmental Organisations (NGOs) and bank linkage programmes have been taking roots in the rural Karnataka. It will be necessary to supplement and enhance credit flow through such institutions keeping in view their tract records. For building confidence in the SHG movement One can also think of a federation of SHGs and NGOs operating in the credit sector.

Appendix Table 1

Disbursement of loans for Agri. and Allied Activities(ST and LT) - Share in Total Disbursements (%)

Region/State	1990-91	1995-96	2001-02
Northern Region	**12.9**	**11.6**	**19.9**
Haryana	2.8	2.2	4.4
Himachal Pradesh	0.2	0.4	0.6
Jammu and Kashmir	0.2	0.1	0.2
Punjab	6.3	5.7	10.4
Rajasthan	3.2	2.5	3.6
Chandigarh	0.1	0.6	0.5
Delhi	0.1	0.1	0.1
North-Eastern Region	**0.4**	**0.4**	**0.5**
Assam	0.2	0.3	0.3
Manipur	0.0	0.0	0.0
Meghalaya	0.0	0.0	0.0
Nagaland	0.0	0.0	0.0
Tripura	0.0	0.0	0.1
Arunachal Pradesh	0.0	0.0	0.0
Mizoram	0.0	0.0	0.0
Eastern Region	**8.3**	**6.4**	**7.4**
Bihar	2.4	2.0	2.2
Jharkhand	0.0	0.0	0.4
Orissa	3.0	1.5	1.0
Sikkim	0.0	0.0	0.0
West Bengal	2.8	2.9	3.8
Andaman & Nicobar Islands	0.0	0.0	0.0
Central Region	**16.9**	**16.4**	**14.1**
Madhya Pradesh	7.5	9.0	3.9
Chhattisgarh	0.0	0.0	0.5
Uttar Pradesh	9.4	7.5	9.3
Uttaranchal	0.0	0.0	0.5
Western Region	**13.6**	**17.1**	**14.4**
Gujarat	5.1	9.8	7.2
Maharashtra	8.3	7.0	7.1
Daman & Diu	0.0	0.0	0.0
Goa	0.1	0.3	0.1
Dadra & Nagar Haveli	0.0	0.0	0.0
Southern Region	**47.9**	**48.0**	**43.8**
Andhra Pradesh	14.5	15.5	13.5
Karnataka	6.3	8.8	9.7
Kerala	8.2	6.2	5.5
Tamil Nadu	18.6	17.1	14.9
Pondicherry	0.3	0.3	0.3
Lakshadweep	0.0	0.0	0.0
All-India	**100.0**	**100.0**	**100.0**

Source RPCD, RBI

Appendix Table 2

District-wise Annual Average Growth Rates (%) of Outstanding Credit by SCBs

Districts	1981-91		1992-2000		1981-2000	
	Agriculture	Total	Agriculture	Total	Agriculture	Total
Highly developed						
Dakshina Kannada	15.1	15.9	9.1	13.7	8.4	11.9
Mysore	14.2	16.0	11.3	15.4	9.8	13.4
Mandya	21.9	16.7	10.2	12.1	14.3	13.4
Shimoga	23.9	17.6	7.3	9.6	13.9	11.9
Belgaum	15.2	15.8	12.9	13.7	11.9	13.0
Group Total	**16.8**	**16.2**	**10.7**	**13.6**	**11.2**	**12.5**
Developed						
Bellary	17.2	17.3	11.3	14.0	10.9	13.8
Bangalore	20.9	17.1	12.6	19.7	15.6	17.7
Kolar	17.6	15.3	8.0	13.7	12.7	13.7
Chikmagalur	11.3	13.9	23.7	24.3	14.1	15.7
Kodagu	13.0	15.1	20.5	21.8	12.2	13.7
Group Total	**16.9**	**16.8**	**15.5**	**19.7**	**13.8**	**17.2**
Backward						
Tumkur	21.4	19.1	11.3	12.8	15.3	14.6
Hassan	15.8	14.8	16.5	18.2	13.8	14.4
Chitradurga	21.6	19.3	16.9	15.9	16.3	15.5
Uttar Kannada	14.9	14.3	12.4	15.3	9.4	12.7
Dharwad	19.0	16.7	11.1	14.3	11.6	13.9
Group Total	**18.6**	**16.9**	**14.0**	**16.5**	**13.5**	**14.2**
Highly backward						
Raichur	14.3	15.5	13.4	13.7	13.5	13.6
Bijapur	20.2	17.3	16.2	15.4	16.7	16.8
Gulbarga	17.0	22.3	15.1	14.2	14.7	17.3
Bidar	18.5	21.2	11.3	13.9	14.6	17.4
Group Total	**17.1**	**18.2**	**15.3**	**15.5**	**14.9**	**15.7**
All	**17.2**	**16.7**	**12.2**	**16.9**	**13.2**	**15.6**

Source: Reserve Bank of India (various issues of *Banking Statistics* from 1981 to 2000) for a note prepared by Rajasekher and GB Sahu, Submission for Karnataka Development Report, ISEC, Bangalore.

Appendix Table 3

District-wise Agricultural Sector Lending (%) to Total Credit and Total Deposits

Districts	Average for the period of 1981-85		Average for the period of 1986-90		Average for the period of 1991-95		Average for the period of 1996-2000	
	ACBC	**ACBD**	**ACBC**	**ACBD**	**ACBC**	**ACBD**	**ACBC**	**ACB D**
Highly developed								
Dakshina Kannada	15.9	9.8	16.0	11.3	12.9	6.1	10.1	3.9
Mysore	26.3	22.8	25.1	22.9	19.8	13.5	16.0	9.9
Mandya	40.6	34.6	51.0	47.2	50.0	36.7	44.8	28.8
Shimoga	22.2	24.0	29.3	38.6	31.6	30.8	28.6	21.4
Belgaum	41.2	26.8	41.3	28.5	38.0	22.1	36.4	20.0
Group Total	**25.2**	**18.3**	**26.5**	**21.5**	**24.2**	**14.4**	**21.1**	**10.7**
Developed								
Bellary	40.9	48.0	47.7	65.3	37.3	36.5	28.8	28.0
Bangalore	6.7	5.4	8.3	7.0	7.4	5.8	4.9	3.8
Kolar	45.9	40.7	54.7	46.2	53.2	35.1	40.7	26.8
Chikmagalur	67.3	65.1	60.1	59.7	57.4	48.7	54.9	58.1
Kodagu	67.2	51.3	61.7	49.2	59.7	32.7	55.8	34.1
Group Total	**15.5**	**12.7**	**16.5**	**14.4**	**13.3**	**10.3**	**10.0**	**7.9**
Backward								
Tumkur	34.4	22.8	36.4	29.5	39.4	25.7	35.5	20.8
Hassan	51.6	42.9	54.5	44.6	52.3	37.1	47.5	34.4
Chitradurga	34.6	26.8	37.7	40.3	36.8	31.5	37.3	38.1
Uttar Kannada	25.5	13.8	26.8	14.6	19.2	8.0	16.8	6.7
Dharwad	31.2	21.2	37.8	28.8	30.6	18.9	23.5	14.4
Group Total	**34.8**	**24.0**	**38.7**	**30.5**	**35.4**	**26.6**	**31.5**	**19.7**
Highly backward								
Raichur	48.6	61.8	46.9	52.6	49.4	45.5	47.7	41.1
Bijapur	40.7	29.2	54.8	37.6	46.7	31.9	48.8	27.5
Gulbarga	49.9	30.5	38.1	29.4	32.9	20.7	36.6	20.8
Bidar	55.3	42.0	48.8	38.0	42.7	29.5	38.2	24.0
Group Total	**46.8**	**39.1**	**47.1**	**39.0**	**43.5**	**31.5**	**44.2**	**28.1**
All	**23.0**	**17.9**	**24.5**	**20.6**	**20.8**	**14.6**	**16.9**	**11.6**

ACBC = Agricultural sector credit as a proportion to net bank credit
ACBD = Agricultural sector credit as a proportion to net bank deposit.
Source: Reserve Bank of India (various issues of *Banking Statistics* from 1981 to 2000) for a note prepared by D Rajasekher and GB Sahu, Submission for Karnataka Development Report, ISEC, Bangalore.

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[1] The prominent among these are All India Rural Credit Survey Committee (1951), All India Credit Review Committee (1966), Nationalisation of major commercial banks (1969 and 1980), Working Group on Rural Banks (1975) and establishing of RRBs (1975).

[2] As per the Master Circular of the RBI, advances to the agriculture sector, both direct and indirect, should be 18 % of the Net Bank Credit. In the case of indirect loans and advances, there is a cap of 4.5 % and in case a bank exceeds the limit, the excess would not be reckoned towards the 18 % target. This is a marked departure from its earlier policy, where there were separate targets for direct and indirect advances.

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