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Trends in Rural Finance*

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The post-Independence banking development since 1947 and in particular post-nationalisation banking progress in 1969 continued until the end of the 1980s, received adequate attention due to the positive role played by banks in accelerating the process of development in India. Hence I propose to focus my address on trends and issues relating to rural finance during the post-reform period.

I

TRENDS IN RURAL CREDIT

The financial sector reforms since 1991 and the emphasis on implementation of prudential norms, i.e., income recognition, asset classification, provisioning norms and Capital Risk Weighted Assets Ratio (CRAR), were instrumental in compelling the commercial banks to concentrate on the financial efficiency and economic viability through rationalisation of their operating system, consolidation of their branch network, which resulted in relocation of many bank branches, concentrating on core strengths reducing the surplus staff as also computerisation of operations.

1.1 Overall Credit Flow

Over time, the flow of credit to agriculture and rural sector has expanded impressively. The ground level credit flow had registered an increase (in real terms with 1993-94 prices) from Rs. 13,915 crore in 1991-92 to Rs. 49,401 crore in 2003-04 and further to Rs. 92,125 crore in 2005-06. The estimated annual compound growth in credit to the agriculture sector in real terms was 14.5 per cent (with 14.1 per cent growth in production credit and 14.9 per cent growth for investment credit during the above period). While the annual growth rate in production and investment credit flow (in real terms) during 1991-92 and 2003-04 were 11.5 per cent and 10.5 per cent, respectively, their respective growth rates during 2003-04 and 2005-06 were 31.3 per cent and 45.1 per cent. However, the maximum growth in credit flow were registered during 2004-05 and 2005-06 when agricultural credit was doubled during two years instead of the targeted three years.

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1.2 Agency-wise Credit Flow

The analysis of agency-wise credit flow indicates that the co-operative banks were the major source of agricultural credit in 1991-92 constituting 53.7 per cent of the total ground level credit flow of Rs. 13,915 crore (in real terms with 1993-94 prices) followed by commercial banks at 41.2 per cent (Rs. 5,731 crore) and regional rural banks at 5.1 per cent (Rs. 712 crore). Though co-operative banks had dominated agricultural credit supply during the early reform period, commercial banks and RRBs recorded impressive growth rates. As a result, in 2005-06, the share of co-operative banks in the total institutional credit flow receded to 21.9 per cent and that of commercial banks advanced to 69.7 per cent. Although the quantum of disbursement for co-operative banks increased, it could not keep pace with commercial banks in enhancing the credit flow due to several reasons including its poor financial health, dual control, lack of internal controls and corporate governance norms and excessive dependence on other financial institutions.

The reasons for the massive increase in the credit flow for commercial banks and regional rural banks could be attributed to the linkage of self-help groups (SHG) with banks since 1992, introduction of the scheme of Kisan Credit Cards (KCC) in 1998, formulation of the Special Agricultural Credit Plans (SACP) by the public sector banks since 2004-05, and monitoring under the scheme of doubling of credit in 2004-05.

1.3 Size-wise Credit Flow

Despite impressive growth in direct credit to farmers from the scheduled commercial banks between 1991-92 and 2003-04, contrary to expectation, credit disbursement to small and marginal farmers has not been encouraging. However for small farmers and other farmers respectively, the number of accounts increased from 44.4 lakh and 36.7 lakh in 1991-92 to 48 lakh and 43.8 lakh in 2003-04. The percentage of marginal farmers to total farmers came down from 42.8 in 1991-92 to 39.8 in 2003-04, while the same for other farmers increased from 25.9 to 28.7. Further, the average annual growth rate in the number of accounts and the amount of credit outstanding during the period between 1991-92 and 2003-04 were 0.62 per cent and 6.2 per cent respectively. One important observation from the above findings is that the credit amount per account had increased without any increase in the number of accounts. Further, increase in credit flow favoured the richer farmers.

1.4 Region wise Credit Flow

While analysing the pattern of credit flow, it is observed that the proportions of bank deposits and credit shares have moved in favour of the South, West and North regions. While the share of loans in the total disbursement of credit for agriculture

and allied activities were the maximum for the South region (47.9 per cent in 1990-91 and 43.7 per cent in 2001-02), it was the minimum for North-east region (0.4 per cent in 1990-91 and 0.5 per cent in 2001-02).¹ The population per rural branch, which was estimated at 16,335 and 16,402 respectively in the North-east and East regions in 1991, increased to 22,158 and 21,208 respectively in 2005. Further, when the number of savings accounts for every 100 persons in rural areas of the North-east region had shown a marginal rise from 16.1 in 1991 to 16.4 in 2005, during the same period, the number of savings accounts in the Eastern region had declined from 17.7 to 16.9. Similarly, in the case of number of credit account for every 100 persons in rural areas, the number reduced from 4.4 and 7.2 in North-east and East regions in 1991 to 3.2 and 4.2 respectively, in 2005.

1.5 Advances to Priority Sector

Although with the rise in net bank credit, the credit flow for priority sector by the scheduled commercial banks had increased, in percentage terms, it remained stagnant at around 36 per cent over the last 14 years. While the net bank credit of the scheduled commercial banks increased from Rs. 1,45,250 crore (in real terms at 1993-94 prices) in 1991 to Rs. 5,75,090 crore in 2005 at an annual compound growth rate of 10.3 per cent, the advances to priority sector increased from Rs. 53,125 crore to Rs. 2,05,000 crore at an annual compound growth rate of 10.1 per cent. As a result, the gap between these two has been widening. Further, the zig-zag trend, i.e., downward during 1991 and 1996 and upward during 1996 and 2005, of the priority sector lending as a percentage to the net bank credit of the banks during the period between 1991 and 2005 shows that no consistent effort has been made to step up advances in favour of the priority sectors. With the new norms for the priority sector announced by the Reserve Bank of India in 2007, it is expected that the commercial banks would be able to achieve the targets fixed.

1.6 Credit-Deposit Ratio

The credit-deposit ratio (CDR), which is an important indicator of deployment of the resources of bank, had been showing a downward zig-zag movement during the last 14 years. The deposits and credit of the scheduled commercial banks in rural areas, which were Rs. 36,961 crore and Rs. 22,168 crore (in real terms at 1993-94 prices) in 1991, increased to Rs. 1,09,005 crore and Rs. 56,254 crore respectively, in 2005. Thus, the credit-deposit ratios had declined from 60 per cent in 1991 to 51.6 per cent in 2005.

However, the credit-deposit ratios of the banks in urban areas had increased from 62.3 per cent in 1991 to 68 per cent in 2005. When the pattern of the credit-deposit ratios for rural and urban areas are observed, we find that the CDR of the banks

operating in urban areas are positioned above the overall CDR and that of rural areas are positioned well below the overall CDR.

While the credit-deposit ratio of the rural branches of the scheduled commercial banks declined during the period between 1991 and 2004, that of the urban offices had shown some improvement with declining and increasing trend in some years during the same period. However, the credit-deposit ratio for rural and urban areas increased from 43.6 per cent and 60.4 per cent in 2004 to 51.6 per cent and 68 per cent respectively in 2005. During the period between 1991 and 2005, while the annual growth rates in the volume of deposits and credit for urban areas were 10.2 per cent and 10.9 per cent respectively, the same for rural areas were 8 per cent and 6.9 per cent respectively. Thus, while in urban areas, the growth rate of credit was higher than that of deposits, in rural areas, the growth rate in deposits was higher than that of credit.

1.7 Branch Expansion

The Indian banking system has acquired a wide outreach, judged in terms of expansion of branches and the growth of deposits and credit. The expansion of the branch network peaked in the phase of social banking during the 1970s and 1980s. Although the Narasimham Committee had recognised the need for continuing with the expansion of banking infrastructure in rural areas, in the process of executing financial reforms, the importance of rural financial infrastructure has got neglected and the number of branches of the scheduled commercial banks declined steadily in rural areas and increased in urban areas. For instance, in 1991, there were 35,206 rural branches out of the total 60,220 branches of the scheduled commercial banks. But in 2006, while the total number of branches of the scheduled commercial banks was 69,471, the number of rural branches had reduced to 30,579. Thus, the financial system has become increasingly urban-centric. Urbanised staff members of commercial banks perceive rural postings as a punishment and serve out their mandatory rural postings, rather grudgingly. The Voluntary Retirement Scheme (VRS) in commercial banks has also ensured that rural branches remain undermanned. Rural postings are avoided because of poor infrastructural facilities, lack of communication, poor transport facilities, lack of good educational opportunities and also due to reduction in perks and allowances.

The trend analysis presented above brings out the fact that financial inclusion by way of credit to rural sectors as also small and marginal farmers, is a distant dream and demands evolution of appropriate strategies. This aspect has drawn the attention of the Government, RBI and NABARD in recent years and a series of interventions have been initiated to enhance credit flow in favour of priority sectors and the disadvantaged sections of the society. Some of the initiatives have been enumerated in the next section.

II

RECENT INITIATIVES

2.1 Government of India and Reserve Bank of India

In order to increase credit flow to the agriculture sector, the policy of doubling of agricultural credit in three years was introduced in 2004-05. In 2004, the Central Government constituted a Task Force to revive the rural co-operative credit institutions under the Chairmanship of Prof. A. Vaidyanathan. In order to expand the outreach of the banking services, banks made available basic banking 'no-frills' account with low or nil minimum balances as well as low or no charges in 2005. The regional rural banks were also specifically advised to allow limited overdraft facilities in 'no-frills' accounts without any collateral or linkage to any purpose.

For opening account with banks, procedures have been simplified by introducing the concept of 'Know Your Customer (KYC)' drill. In January 2006, banks were permitted to utilise the services of Non-Governmental Organisations (NGOs), Self-Help Groups (SHGs) and other Civil Society Organisations (CVOs) as intermediaries in providing financial and banking services through the use of Business Facilitator (BF) and Business Correspondence (BC) models. The BC model allows banks to do 'Cash in – Cash out' transactions at the location of the business correspondent and also permits branchless banking. With the objective of providing revolving credit to the rural people, banks in rural and semi-urban areas have been advised to provide a General purpose Credit Card (GCC) facility. For all borrowers having a principal amount of less than Rs. 25,000 and whose accounts have become non-performing assets (NPA), banks have been requested to offer a One Time Settlement (OTS) Scheme. It is expected that such a provision will restore the borrowing relationship of small borrowers with the formal system and thereby obviate the need to go back to the informal system. In June 2007, a multilingual website in 13 Indian languages on all matters concerning banking was launched by RBI for credit counselling and financial education. In 2007-08, two funds, i.e., Financial Inclusion Fund (FIF) for promotional interventions and Financial Inclusion Technology Fund (FITF) for meeting cost of technology adoption are proposed to be established with the National Bank for Agriculture and Rural Development (NABARD).

(ii) NABARD

Complementing its core financing and developmental functions in tune with the emerging challenges, NABARD has been pioneering innovative rural interventions for ensuring sustainable development and prosperity. In its long journey for the development of farm and non-farm sectors through credit and other support services, initiatives such as Potential Linked Credit Plans (PLPs), District Development Offices, Participatory Watershed Development Programme, non-farm sector

promotional programmes, Self-Help Group–Bank Linkage programmes, Rural Infrastructure Development Fund (RIDF), Kisan Credit Card (KCC), Swarojgar Credit Card (SCC), Consultancy Services, tribal development programmes, farmers' clubs, etc. have contributed immensely. The initiatives of the Bank centre around (i) exploring innovative investment opportunities, (ii) investing partners for Financial/ Technical assistance, (iii) creating infrastructure base, (iv) developing leadership, entrepreneurship and capacity building, (v) educating the rural masses, (vi) building sound network of rural financial institutions, (vii) continuous innovations in delivery procedures and systems, (viii) credit planning and (ix) support Research & Development activities in the areas of agriculture and rural development. In order to augment the much needed institutional credit, NABARD included financing of housing in rural areas as an eligible activity for extension of refinance under investment credit to financial institutions since 1 April 2001 subject to a maximum of Rs.5 lakh for a dwelling unit.

The major initiatives of NABARD, which have had a direct impact on the rural credit delivery mechanism and touched and transformed the lives of millions of rural people, are as follows:

(a) SHG-Bank Linkage Programme

The SHG-Bank Linkage programme, which came as a corporate strategy in 1992, aims at improving access of the weaker and other sections of the society from formal financial institutions. It has been built around a simple but basic aspect of human nature – '*the feeling of self-worth*'. The ability of people to pool their micro-savings, provide collective social collateral for banks to lend against and add to the SHGs' funds and the collective alteration of funds to meet the emergent credit needs of the SHG members, rates which reflect risks and management cost of funds, are the unique features of this movement which has enabled banks to assist in meeting the credit needs of very poor people without sacrificing their funds and has helped the rural women especially to empower themselves both economically and financially. Over the last 15 years, the Micro-Finance initiative of NABARD has passed through various stages like pilot testing (1992-95), mainstreaming (1996-98) and expansion (1998 onwards) and has assumed the shape of a micro finance movement in the country by linking around 30 lakh SHGs with the formal banking system by March 2007. Further, the programme has enabled an estimated 394 lakh poor households to gain access to funds from the formal banking system. Studies conducted by various experts show that the programme has indeed helped in the social and economic empowerment of rural folk, especially women, causing significant upscaling of social capital while at the same time delivering crucial financial services. Today, it has expanded to become the largest micro finance programme in the world in terms of its outreach and has extended banking services to people hitherto under-served by the banking system.

(b) Joint Liability Groups (JLGs)

Absence of ability to provide adequate collateral security acts as a major hurdle for landless/tenant farmers in securing loans. The inability of this section of farmers to provide collateral often excludes them from the purview of formal credit cover. Keeping this in view, a pilot project on financing Joint Liability Groups (JLG), was initiated for developing effective credit products for such clients, which reduce risk and transaction costs for the banks and also introduce a greater degree of flexibility for the credit users to determine their credit needs and priorities. Joint Liability Groups (JLG), to be established under the pilot project, will be a group of 5-10 member clients who are together informally recognised by the bank as a group. The group members offer an undertaking to the bank that enables them to jointly receive such amounts as deemed eligible by the bank for pursuing any activity, individually or jointly, as found suitable by the group. The group serves as collective guarantor for loans extended to individual members by executing joint liability agreements, making them severally and jointly liable for repayment of loans to the group. Although the JLG credit model was pilot-tested for mid-segment farmers, the concept could very well be extended to tenant farmers/oral lessees/ sharecroppers also.

With a view to promoting the scheme on a large scale, banks may be allowed to adopt "Agency Model" by involving civil society organisations, NGOs, Farmers' Clubs, Village Knowledge Centres, Panchayats, various User Groups such as Water Users' Associations, etc. Their services could also be made use of for performing various non-financial functions for the bank such as borrower identification, preliminary appraisal, promotion and nurturing of JLGs, etc.

(c) Financing Rythu Mitra Groups

An approach similar to TFGs or JLGs was also adopted in Andhra Pradesh, with the initiative of the State Government. The programme called Rythu Mitra Groups, which envisages bringing about holistic development in the lives of small/marginal/landless farmers through collective action. RMGs are expected to serve as a conduit for technology transfer, facilitate access to market information and market, assist in carrying out activities like soil testing, training, health camps, assess input requirements, etc., for its members. NABARD provides resource and grant assistance for conducting training and capacity building initiatives to different stakeholders. During the year, 4437 RMGs were financed by 18 commercial banks, 9 RRBs and 9 DCCBs involving ground level credit flow of Rs. 28.11 crore. About 62,000 farmers have been assisted under the pilot project.

(d) Kisan Credit Card Scheme

During the year 1998-99, NABARD introduced the Kisan Credit Card (KCC) Scheme in conjunction with co-operative banks, commercial banks and regional rural

banks to smoothen and strengthen the credit delivery system and more particularly, to make available timely and hassle-free crop loans to the farmers. As on 28 February 2007, 665.6 lakh KCCs had been issued by the banking system. Of the total 665.6 lakh cards, the co-operative banks accounted for the largest share of 49 per cent followed by commercial banks (38 per cent) and regional rural banks (12 per cent). Recognising it as an accepted mechanism for delivery of credit to farmers, the banking system has been routing crop loans through the Kisan Credit Cards. To cover the KCC holders against accidental death/permanent disability and partial disability upto Rs. 50,000 and Rs. 25,000, respectively, an insurance scheme was formulated by the General Insurers' (Public Sector) Association of India (GIPSA) in close co-ordination with the NABARD. Banks have been advised to implement the scheme with effect from the *kharif* 2001 season. All the KCC holders are required to be covered under the scheme by payment of a nominal premium amount. With a view to making KCC more user-friendly and comprehensive, NABARD has further enlarged the scope of the Scheme to cover long-term loans and consumption loans along with crop loans.

The joint studies conducted by NABARD and the financing banks on the implementation of the KCC scheme have confirmed that the scheme was well received both by the farmers and bankers and the flexibility in operations has resulted in improved loan recoveries. For many banks, some ground level constraints like adoption of selective approach in identifying beneficiaries, reluctance to extend KCC facility in mono-crop areas, levy of costly service charges and levy of stamp duty by some of the State Governments for issuing loans under KCCs, were observed.²

(e) Swarozgar Credit Card (SCC) Scheme

The Swarozgar Credit Card scheme was introduced in 2003 for facilitating hassle free availability of credit for meeting investment and working capital requirements of small borrowers and rural micro-entrepreneurs. As on 31 March 2007, the banking system had issued 6.79 lakh cards involving credit limits of Rs. 2,700 crores.

(f) Rural Infrastructure Development Fund

With an objective of quicker completion of ongoing rural infrastructure projects, the Rural Infrastructure Development Fund (RIDF) was set up with NABARD during 1995-96 with an initial corpus of Rs. 2,000 crore. In the Union Budget for 2006-07, the XII tranche for RIDF was announced with an allocation of Rs. 10,000 crore raising the aggregate allocation to Rs. 60,000 crore. As on 31 March 2007, the cumulative number of projects sanctioned rose to 2,44,025 and the amount sanctioned increased to Rs. 61,539.87 crore. Although initially it was meant mainly for incomplete projects in irrigation, rural roads and rural bridges, its scope has now been extended to cover major infrastructure projects in various sectors like irrigation,

roads, bridges, power, market yards, godowns, cold storages, information technology, primary education and health systems.

III

ISSUES AND CONCERNS

3.1 Financial Exclusion

The Situation Assessment Survey (NSSO, 2003) indicated that out of the total 89.3 million farmer households in the country, 84 per cent (750 million) households were small and marginal farmers and more than half (51.4 per cent) of the total households were non-indebted. Further, out of the total 43.4 million indebted households, 20.3 million (46.8 per cent) households had availed financial services from informal sources. The inference of these findings is that in spite of a large network of the institutional credit system, it has not been able to adequately penetrate the informal rural financial markets and the non-institutional sources continue to play a dominant role in purveying the credit needs of the people residing in rural areas. The results of the All-India Debt and Investment Survey (AIDIS, 2002) also indicate that the share of the non-institutional sources, in the total credit of the cultivator households, had increased from 30.6 per cent in 1991 to 38.9 per cent in 2002.

3.2 Slow Down of Credit Flow to Rural Areas

The ratio of rural lending to total lending has been steadily declining during the 1990s. In 1991, the total credit of the scheduled commercial banks, in nominal terms, had increased from Rs. 1,21,865 crore, to Rs. 15,13,842 crore in 2006. However, the share of rural areas in the total deposits and credit of the scheduled commercial banks, which were 15.5 per cent and 15 per cent respectively, in 1991, decreased to 10.8 per cent and 8.3 per cent, respectively in 2006, reflecting the inability of the rural areas to absorb funds for developmental purposes.

3.3 Declining Flow of Credit for Agriculture Sector

While studying the flow of institutional credit to agriculture sector during the period between 1991-92 and 2005-06, an impressive growth in both production and investment credit has been observed. However, the pace of growth had definitely been accelerated during the operation of the scheme of doubling of credit. Production credit, which was 60.7 per cent of the total credit flow of Rs. 13,915 crore (in real terms) in 1991-92, had declined to 58.5 per cent of the total credit flow of Rs.92,125 crore (in real terms) in 2005-06. It is also a concern that although the co-operative banks are in close proximity with the rural people, the share of co-operative banks in the total credit flow for agriculture sector had declined from 53.7 per cent in 1991-92 to 21.9 per cent in 2005-06. Further, the share of the regional rural banks in

the total credit flow had increased from 5.1 per cent in 1991-92 to only 8.5 per cent in 2005-06, when with the existing branch network of over 14,494 branches, they could meet the credit needs of 25 per cent of the rural areas.

3.4 Neglect of Small and Marginal Farmers

During the period between 1991-92 and 2003-04, while the number of accounts for marginal, small and other farmers had increased at annual rates of 0.03 per cent, 0.65 per cent and 1.48 per cent, respectively, the credit flow to the respective categories of farmers had increased at 6.71 per cent, 6.73 per cent and 5.7 per cent. Overall, during 1991-92 and 2003-04, while the annual increase in the number of accounts was 0.62 per cent, the increase in the amount of credit outstanding of farmers was 6.2 per cent. Thus, during the last 10 years, although there is no meaningful increase in the number of accounts in favour of farmers, there has been a meaningful increase in the volume of credit outstanding of the farmers. Further, during the period between 1991-92 and 2003-04, the percentage of the number of accounts with marginal farmers had been declining and that of other farmers had been increasing. For instance, the share of marginal, small and other farmers in the total number of accounts, which were 42.8 per cent, 31.3 per cent and 25.9 per cent respectively in 1991-92, reduced to 39.8 per cent, 31.5 per cent and 28.7 per cent for the respective category of farmers in 2003-04. Thus, over time, while credit deepening has taken place, credit widening has not yet been effectively addressed. Alternatively, it could be stated that farmers have become more prosperous, migrating to the better-off categories.

3.5 Falling Advances to Priority Sector

Over years, priority sector lending as a proportion of net bank credit has been declining. For the public sector banks, priority sector lending as a percentage to net bank credit had decreased from 41.8 per cent in 1991 to 40.3 per cent in 2006. In the priority sector itself, the shares of agriculture and small-scale industries had decreased from 40.7 per cent and 39.1 per cent in 1991 to 37.7 per cent and 20.1 per cent respectively in 2006. While in 1989, it had been stipulated that all banks need to provide 18 per cent of their net bank credit for the agriculture sector, by March 2006, only 10 public sector banks and one private sector bank had achieved it. Similarly, only 8 public sector banks and one private sector bank had met the sub-target of 10 per cent of the net bank credit for the weaker sections.

3.6 Reduction in Rural Bank Branches

In spite of the process of financial reforms in the country, the total number of bank branches of the scheduled commercial banks had increased from 60,220 branches in 1991 to 69,471 branches in 2006, at an annual rate of 0.96 per cent.

While the number of bank offices in urban areas had increased from 25,014 branches in 1991 to 38,892 branches in 2006 at an annual rate of 2.99 per cent, the number of branches in rural areas had declined from 35,206 branches in 1991 to 30,579 branches in 2006 at an annual rate of 0.93 per cent. The influence of the declining trend of the bank branches in rural areas had been felt in marginalisation of the disadvantaged sections from accessing institutional credit, especially in the underdeveloped regions of the country. This has to some extent been offset by the SHG-Bank linkage programme, which provided credit to very poor people, especially poor rural women.

3.7 Credit Flow vs. Productivity

Although credit for the agriculture sector has shown an impressive growth over a period of time between 1991-92 and 2005-06, no significant change in the value of output has been observed during this period. The relationship between the value of input and the value of output over the last decade has remained more or less the same with the output being less than five times the value of input. It is relevant to note that even at the highest level of production, credit forms around 11 per cent (in real terms at 1993-94 prices) of the total output value. Thus, expecting credit with so little a share in the output value to have any significant impact on the output or productivity values may not be in order.

IV

EMERGING CHALLENGES

There has been a long history of concern regarding rural credit. The increase in the share of institutional credit has been rather slow. The dependence of small and marginal farmers is still very high on non-institutional sources. Besides, the developed regions have greater access to credit as compared with less developed regions (Dadibhavi, 1988; Giri and Dasgupta, 1988). Therefore, the key issue now is how to ensure that rural credit from institutional sources achieves wider coverage and expands financial inclusion. As the credit-off-take depends on the willingness and ability of the person to avail loans (which is a function of perceived returns to investments) and the willingness of the banker to lend (which is contingent on bank's perception and assessment of lending risk), there is a need to address the problems from both the supply side as also the demand side.

While distance from the bank branch, branch timings, cumbersome documentation and procedures, unsuitable products, communication and staff attitudes are some important supply side constraints, lack of awareness, low income/assets and small-sized loan demands are some of the demand side constraints. Further, large number of villages (more than 6 lakh villages), lack of infrastructure, vast geographical spread, high transaction costs and poor loan recovery are some

other problems faced by banks. In the absence of any alternative, the poor and other weaker sections of rural society depend on the unorganised financial system, which utilises local knowledge, offers credit for a wide variety of purposes and operates quite flexibly, though at high costs and as an exploitative relationship.

One strategy that has achieved great popularity and wide acceptance is that of micro finance. The banks need to involve micro-finance agencies and other financial intermediaries, as business opportunities. They must understand, recognise and streamline different activities like retail activities, service sector initiatives, and construction and rural housing that take place in the rural economy, in addition to financing agriculture. However, this needs innovations in risk assessment, reduction in transaction costs, search for new credit channels and the use of cheaper information technology.

Technology is another option. It can be a vital component in integrating strategies for achieving inclusive growth. Its use can be critical in building up a reliable credit information system and database on customers, reducing transaction costs and facilitating better pricing of risk, improving the efficiency of the financial system, and thereby increasing the access of un-banked rural people in an efficient manner. It can reduce the transaction costs sharply and time taken by banks in processing applications, maintaining accounts and disbursing loans. It has the potential to address the issues of outreach and credit delivery in rural areas, in a cost effective manner. But how the IT platform will provide a variety of financial services to the rural clients at affordable costs and in time needs to be examined.

Access to information is the key to ensure wider participation of all in the process of development. The challenge lies in ensuring easy flow of public information to rural citizens. The growing innovations in the use of information communication technologies have opened up a new era of information dissemination. Credit counselling, awareness creation and financial education regarding the benefits of financial inclusion are important for effective expansion of financial services in rural areas. To do this, banks may utilise the services of non-governmental organisations, village youth clubs, village Panchayats, farmer clubs and self-help groups into confidence.

Banks need to develop an array of financial products and services that are adapted to the needs of the majority of rural people at affordable prices. Interest rate is an important component of cost to agricultural producers and will become more important as backward and forward linkages are strengthened. As per the current interest rate policy of RBI, the interest rate on loans for the agriculture sector by commercial banks are linked to the size of the loan. While commercial banks have reduced their interest rates on crop loans up to Rs. 50,000 to 7 per cent, RRBs and co-operative banks, for various reasons, have not been able to bring down their rates of interest on lending to any appreciable extent. To ensure competitiveness of Indian agricultural produce in the world market, various Committees have suggested several measures of reducing cost of funds, transaction costs and the risk costs.

Risk management is another option. While the farmers suffer from wide variety of risks like the climate risk, price risk, technology risk, etc., the bankers suffer from the problem of increasing non-performing assets and losses. These risks emanate from a host of factors including failure of investments, willful defaults, weather aberrations, improper appraisal of loans, diversion of funds, inadequate monitoring and follow up and inability to realise the securities available, are some of the cost drivers, which play a decisive role in determining the rates of interest charged by banks to ultimate borrowers in the rural areas. Therefore, if credit risk can be disaggregated into factors like failure of rainfall, price fluctuations, poor health and death of the borrower, these can be mitigated through non-credit financial products like insurance and derivatives. This could also facilitate the banks to provide credit at lower rates.

On account of low levels of financial capacity as also awareness, risks affect lives and livelihood of the poor. Therefore, the risk management mechanisms should take into account the similarities and differences in the incidence of risks and seek to assist people to manage the consequences thereof. One possible risk management measure could be to enhance savings. Creation of a large fund administered centrally or at each State level would be necessary to help people affected by calamities and disasters. The manner of contribution, mode of assistance, etc., could be designed to provide quick response to calamity-affected regions. Price hedging mechanisms to safeguard farmers from price risks would be needed. The gradual introduction of forward markets and future trading in select crops/commodities should be extended to all major crops in a phased manner. An enforcement mechanism whereby the suppliers of technology are made accountable for failure of technology, etc., could mitigate technology risks faced by the farmers. Further, the infrastructure support, policy framework and technology could play an effective role in mitigating risks in financing to the rural sector. There is also a need for providing immediate relief at the time of disaster or natural calamity, smoothening the liquidity flow to ensure that consumption requirements are not unduly affected besides compensating people for loss of income, assets and livelihood.

The rural Micro Finance Institutions (MFIs), which has emerged as a powerful tool for fighting poverty, may be made a part of the financial system for effective delivery of rural financial services. The banks need to gear up their rural branches for facilitating bank linkages of SHGs where the programme has not shown satisfactory progress. The Business Correspondence models (MFIs, NGOs, etc.), as recommended by the Internal Group on Micro finance (Khan Committee), may also be put in place, which will increase banking outreach.

NOTES

1. Report on Indebtedness of Farmers, Sub-Group V, Page 18.
2. Annual Report, 2001-02, National Bank for Agriculture and Rural Development, pp. 53-55.

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