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INSTITUTIONAL CREDIT IN SUBSISTENCE AGRICULTURE

The main source of supply of credit to subsistence farmers in traditional agriculture is the money-lender. Such credit is invariably very expensive and often exploitative. Attempts to provide credit through co-operatives and other semi-public institutions have not met with much success. The article examines the experience in India and raises some basic issues involved in the transformation of subsistence farming into a commercial enterprise.

Following the recommendations of the All-India Rural Credit Survey by the Reserve Bank of India, the co-operative structure was greatly strengthened through State partnership and liberalization of agricultural credit. As a result, loans advanced by the co-operatives to the farmers have gone up from Rs. 229 million in 1950–1 to Rs. 2,952 million in 1964–5, and their share in total agricultural finance has gone up from 3 per cent. to 15 per cent. Yet a large number of small farmers still depend upon the traditional source of credit.

Dissatisfied with the progress of co-operative credit, the Indian planners are contemplating further changes in the institutional credit structure, e.g. the establishment of Agricultural Credit Corporations.

The author believes that such changes will not be of much avail. The malady of subsistence farming is deeper: liberal and institutionalized credit is helpful, but cannot by itself make an intrinsically non-viable enterprise viable. If the size of holding is extremely small—in size as well as capital intensity—even when farming as such becomes profitable in terms of cost and return, the surplus may be too meagre for the maintenance of the farm family, and does not enable the farmer to repay the loan. The transition from money-lender credit to institutional credit can, therefore, proceed at a pace no faster than the transition of subsistence agriculture into commercial agriculture which it is an integral part of over-all economic development, reduction in the pressure of population on land and diversification of the economy.

IT is a truism to say that supply of adequate and timely credit is a crucial constituent of any programme of agricultural development. Traditionally, in economies dominated by subsistence farming, agricultural credit is supplied mainly by the money-lender and, to an extent, by the trader. Such credit tends to be excessively costly and exploitative. It has pronounced inhibitive effects on production efforts. The borrower is often under compulsion to sell the produce to the lender at a price much below the market price. Replacement of money-lender credit by institutional forms of credit has, therefore, come to be accepted as an important element of agrarian reform.

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In India, this problem has been examined by several expert bodies and discussed extensively by agricultural economists. Till very recently, the consensus has been that the credit co-operative is the most appropriate agency for the provision of agricultural credit. The Report of the Committee of Direction of the All-India Rural Credit Survey (1954) summed up the position by observing: 'Co-operation has failed, but co-operation must succeed.' Following the recommendations made in the Report, a comprehensive programme of reorganization of the co-operative credit structure and liberalization of loan policies and procedure was adopted. A brief review of the major policy changes and their impact on the progress of co-operative credit is given in part one of this article. Though the co-operative credit movement has made striking progress during the last decade, the review reveals several of its shortcomings and limitations. It has obviously not been able to meet the credit requirements of all farmers. This has prompted fresh thinking on the role of the co-operatives in providing credit, and some adjustment in the policy is being made. Part two of this article critically examines this process of change and poses the question whether the problem of agricultural credit in a preponderantly subsistence type of farming can be solved mainly by changes in the institutional frame of credit agencies or by re-orienting and liberalizing their lending policies.

I

One of the major recommendations of the Rural Credit Survey Committee was in regard to the partnership of the State in the co-operative movement. Arguing the case for such partnership, the Committee observed: 'The prescription for the reorganization of co-operative credit hitherto made or tried may be described as attempts to rectify the internal weakness of the credit structure without taking into account the weakness of the rural structure as a whole. Most reforms of the co-operative movement, attempted or effected, have, therefore, been in the nature of inevitably futile attempts to combine the weak against the strong in conditions in which the weak have had no chance.'[1] The Committee therefore came to the conclusion that 'the choice before Co-operation is indefinitely to continue in various degrees to be unable to help itself or to be helped in order that eventually it may not only help itself, but need no other outside

[1] All-India Rural Credit Survey, *General Report*, p. 376, Reserve Bank of India.

help'. It was obvious that the initial help of the requisite magnitude and of a type which will enable the co-operative organization to withstand the pressure of opposition of vested interests could come only from the State. It was made clear that the manner of the help cannot be merely administrative. 'All these years, the State's way of help had been to over-administer and under-finance.' What was recommended, therefore, was not only State guidance and State aid, but a fully-fledged State partnership with co-operatives in credit and allied activities of marketing and processing.

Another major recommendation of the Rural Credit Survey Committee was in regard to the size of the primary unit. The Committee observed: 'It is our considered view that the formula "one society to one village and one village to one society" has failed in India as the basis for the organization of co-operative rural credit.'[1] It, therefore, recommended that the future line of development of co-operative credit at the level of the village should be unhesitatingly in the direction of bigger societies covering larger areas. These societies should cover, according to local conditions, groups of villages with a reasonably large membership and reasonably adequate share capital. It should be capable of providing adequate business for which it should be able to engage the services of a paid secretary.

This recommendation of the Committee came in later for severe criticism on the ground that it ignored the basic principle of the co-operative movement, viz. mutuality of interest. In some States, discretion was not observed in implementing the Committee's recommendation and societies were started covering in some cases as many as 40 villages. Consequently, the programme of starting large-size societies was halted and the matter was referred to another Expert Committee. Fortunately, as a result of the recommendations of this Committee, the controversy on the subject has ended and it has been agreed that the aspect of viability was as important as that of mutual knowledge and contact.[2]

The third major recommendation pertained to the loan policy of the co-operative societies. It was decided that the basis for short-

[1] *General Report*, p. 450.

[2] 'Membership [of the Primary Society] should not be too large and the area not too extensive. No village included in the Society should be at a distance of more than 3 or 4 miles from the headquarters village. The population covered should not exceed 3,000 (i.e. 600 families or 500 cultivating families).' *Report of the Committee of Co-operative Credit* (Chairman: V. L. Mehta), p. 75, Government of India.

term credit should be a system of crop loans. The system may be briefly described as one which concentrates on productive purposes; provides short-term loans on the basis of the crop that is anticipated; relates such loan in amount to the estimated outlay on raising the crop; and, as and when the crop is sold, recovers the loan from the proceeds of the sale. The loan should, to the maximum extent possible, be disbursed in kind. Other important recommendations pertained to the establishment of the State Bank of India by nationalizing the Imperial Bank of India and ten other State-associated banks; establishment of a National Co-operative Development and Warehousing Board; creation of five 'national' funds for financing of reorganization and development of the co-operative credit movement; and integration of credit, marketing, processing and warehousing within a pervasive co-operative structure.

The co-operative credit movement in India has a three-tier structure. At the apex is the State Co-operative Bank, at the district level we have what are called Central Co-operative Banks and at the primary village level there are the Service Societies. At the national level, the responsibility of assisting the co-operative credit movement rests with the Reserve Bank and the National Co-operative Development Corporation. While the Reserve Bank assists the movement by providing long-term loans to the State governments to enable them to subscribe to the share capital of co-operative credit societies and also make available the working capital for their loan operations, the National Co-operative Development Corporation provides them with long-term loans and grants for construction of rural godowns[1] and towards managerial costs. Thirty-seven per cent. of the share capital of the State Co-operative Banks and 27 per cent. of that of the Central Banks have been contributed by the State governments. Concessional finance—at 2 per cent. below the Bank-Rate—is provided by the Reserve Bank for agricultural purposes to the State Co-operative Banks. Outstanding borrowings from the Reserve Bank amounted to Rs. 1,510 million as on 26 March 1965. The amount advanced by the Reserve Bank during 1964–5 for seasonal agricultural operations and marketing of crops was Rs. 2,540 million.

The number of primary agricultural credit societies in 1950–1 was 104,998. By the end of June 1964 this number had increased to 211,361. During this period their membership increased from 4·4

[1] Storage facilities.

million to 24·1 million[1] and covered 83 per cent. of the villages in the country. In six States, viz. Kerala, Madras, Punjab, Maharashtra, Uttar Pradesh and Gujarat, 100 per cent. of villages are covered, the percentage being more than 95 in two other States, viz. Andhra Pradesh and Mysore. Nearly 31 per cent. of the cultivator households in the country had a membership in the co-operative societies; the percentage being more than 72 in Madras. The All-India Rural Credit Survey had estimated that in 1951–2 only 3·1 per cent. of the total amount borrowed by the cultivators was subscribed by the co-operatives. A more recent survey by the Reserve Bank of India has estimated that in 1961–2 loans advanced by primary agricultural credit societies and land mortgage banks aggregated to Rs. 1,605 million or about 15·5 per cent. of the total borrowings of cultivator households.[2] The total volume of short- and medium-term credit advanced by the primary agricultural societies is estimated at Rs. 2,952 million in 1963–4. By the end of June 1964, the share capital of the agricultural credit societies was Rs. 924 million and the working capital Rs. 4,423 million. The level of outstanding loans was Rs. 3,545 million.[3]

Thus, viewed at an aggregate national level, the progress of the co-operative movement appears quite impressive. A closer scrutiny, however, reveals several drawbacks and uneven regional growth. While the newly started large-sized societies are making good progress, several small societies are dormant and languishing. In 1962–3, there were as many as 39,129 dormant societies. The percentage of dormant societies was as high as 72 in Assam, 59·7 in Orissa, 50·5 in West Bengal. More than 12,200 societies were under liquidation. Less than 2·3 per cent. of the societies had the first class (A) audit classification, another 13 per cent. had second class (B), and the rest third and fourth class (C and D) classifications.

The most disquieting feature of the co-operative credit system is the large percentage of 'overdues' to outstanding loans. The per-

[1] *Progress of primary agricultural credit and multi-purpose societies*

Year	*Total no. of societies*	*Membership (in millions)*	*Share capital (Rs. in millions)*	*Working capital (Rs. in millions)*	*Loans advanced (Rs. in millions)*
1950–1	104,998	4·41	76·1	372·5	229·0
1964–5	211,361	24·11	924·5	4,422·9	2,952·0

[2] *All-India Rural Debt and Investment Survey, 1961–62*, Reserve Bank of India.

[3] The average amount of loan advanced per society and per member, however, remains quite low, being Rs. 13,967 and Rs. 122 respectively.

centage increased from 21 in 1959–60 to 25 in 1962–3 and has come down to 22 in 1963–4. The percentage of overdues was as high as 71 in Assam, 48 in Bihar, 46 in Mysore, 45 in Rajasthan. Even in such co-operatively progressive States as Maharashtra and Gujarat, the percentage of overdues to outstanding loans was 29 and 25 respectively.

The expansion of co-operative credit has been facilitated by increasing reliance on borrowings, which accounted for 67·3 per cent. of the working capital. The percentage of owned funds was 26·7 and that of the deposits only 6. The level of working capital per society was Rs. 66,160 in Kerala, but as low as Rs. 4,190 in Bihar and Rs. 5,325 in Assam.

II

The foregoing review reveals that in spite of the massive support given by the Government and the Reserve Bank to the co-operative credit institutions, in several States of India the movement has not been able to meet adequately the credit requirements of the cultivators. Even in States where the co-operative movement is well developed there is a great variation in its performance between the various parts of the States. This has raised doubts about the appropriateness of the credit policy under which the co-operatives were considered as the only suitable agency for the supply of rural credit. An opinion is gaining ground in favour of a multi-agency approach.

An Informal Group of the Reserve Bank, which recently examined this question, has recommended the setting up of Agricultural Credit Corporations in the States of Assam, Bihar, Orissa, West Bengal and Rajasthan. While recognizing the need for a separate credit institution in these States, the Group has emphasized that this should be considered only as a transitional arrangement; and ultimately the co-operative agency alone should be responsible for the provision of agricultural credit. Steps should be taken to strengthen the co-operative structure during the transitional period. Since two agencies would be working simultaneously, a close collaboration between the two is to be ensured. The Ministers for Co-operation in the States and the Registrars of Co-operative Societies, however, have opposed the establishment of Credit Corporations in these States. In their view, in actual practice, the dual system will not work and the Credit Corporations will displace the co-operatives or weaken them. It is anomalous to have two equally favoured and State-supported institutions working side by side and performing identical functions.

A distinct clash of interest has thus emerged between the requirements of the programme of increased agricultural production and the growth of the co-operative movement. There need be no doubt that, so posed, the conflict must be resolved in favour of the former. The growth of the co-operative movement is a very desirable social objective, but it will not be defensible to pursue it if it proves an obstacle in the realization of the vital need to increase agricultural production. The issue of the single *v.* multiple institutional structure cannot be resolved by considering the one or the other as an end in itself.[1] The right way to view it is to assess the two alternatives on their merit, the merit being identified as their capacity to assist agricultural development. What needs to be established is that what the co-operatives have failed to achieve will or can be achieved by other credit institutions. During the last few years, immense expenditure in time and money has been incurred to build up the co-operative movement. It has taken decades for the co-operative movement to take root and function efficiently in some parts of the country. Credit institutions which have to serve thousands of farmers (large numbers of whom carry on subsistence farming over the scattered half a million Indian villages) cannot be built in a hurry. Before launching any new institutions it is necessary to inquire whether better results would not be obtained by spending the time and money required for

[1] The following comment on this made by an esteemed friend and a leading co-operator may be of interest.

'Institutionalized co-operation presupposes a certain progressiveness, self-reliance and organized mutual action on the part of members. Where the process of development has to be initiated in advance of development of these qualities among the people concerned, some more direct and simplified modes of reaching the individual farmers have to be followed. This is as true of credit as of the other essential developmental services. Arrangements cannot be fully institutionalized. They tend to lean in initial stages more on external action than on internal initiative and responsibility. The results are not as satisfactory as they would be in developed stages.

'In developing agrarian communities there is the inescapable problem of starting from a pre-institutionalized stage, and leading them on to a developed and institutionalized stage. No one type of action can serve all such needs, but a state-supported semi-autonomous organization ensuring such immediate results as are judged to be practicable, and providing a built-in arrangement for eventual transformation into a fully functional organization, would appear to be the most promising course to follow.

'Once the existence of the problem and the general line of approach to its solution are accepted, individual solutions may be offered in differing ways, of which the proposed Agricultural Finance Corporation is only one. Its appeal is not directed to the established co-operative institutions and authorities, but to those who are eager to push on with agricultural development even in situations in which normal institutionalization has been judged to be inoperative and unpromising.'

building them, on strengthening the co-operative movement. In other words, we must inquire whether the shortcomings of the co-operative movement are remediable or inherent in its structure. The co-operative movement has revealed the following shortcomings:

(*a*) The availability of short-term credit, though generally inadequate in the country, is more restricted in some areas especially where the co-operatives are weak (for example, Assam, West Bengal, Bihar and Rajasthan);

(*b*) in several States, tenants and marginal cultivators have been unable to obtain co-operative credit;

(*c*) at the other end, credit available to comparatively big farmers and for commercial crops has been inadequate;

(*d*) in areas where comparatively high risks are involved, availability of institutional credit is uncertain; and

(*e*) in times of distress and natural calamity, availability of co-operative credit becomes scarce. Although there are procedures for coping with adverse conditions beyond the control of cultivators, such as extending loans and converting past due short-term loans to medium-term loans, these procedures have invariably resulted in delays and loans for the next crop not being available.

The alternative institutions which are thought of are commercial banks, Food Corporation of India, *Taccavi* Loans from the Government, loans from manufacturers of agricultural equipment and an Agricultural Credit Corporation at the national or State levels.

It would be useful to find out what precise advantage any of these institutions would have over the co-operative societies in dispensing rural credit, and to assure ourselves that they will be immune from the limitations from which the co-operatives suffer. Will their outlay in terms of administrative costs in relation to the amounts lent be any less? Will these agencies acquire at least a part of their financial resources by mobilizing the savings of the rural community or will the entire requirements be met by a draft on the Central Bank and the Government? Will these agencies have a closer contact with the borrower farmers and more intimate knowledge of the magnitude and the nature of their credit requirements and past performance in regard to repayment etc.? Will their management involve the participation of local leadership as is the case with the co-operatives? Will the management be less bureaucratic than that of the co-operatives which is said to suffer from many procedural delays? Will the management cost per borrower or unit of loan be smaller?

It would be difficult to answer all these questions in respect of each of the agencies mentioned above. But even a cursory thought given to these questions would indicate that prima facie none of these institutions appears to have any distinct advantage over the co-operatives in regard to those spheres where the success of the co-operatives has been limited.

It is true that the availability of short-term credit through the co-operatives has been inadequate, but it is necessary to inquire into the reasons for this before condemning the credit institutions. It has been suggested that 'the co-operative credit to be given to the farmer should be based on the assessment of the inputs he would require for achieving production targets rather than on the estimated value of his assets'. Admittedly, given an assurance of reasonable price, the additional returns from larger production would no doubt more than meet the additional productive expenditure for which credit is given. But unless the lender has the prior claim on the marketable surplus or on the sale-proceeds of the crop, the repayment of the loan is not assured —if not related to the value of assets. Credit for the productive purpose is self-financing only in the technical sense. The repayment capacity of the borrower depends, in the ultimate analysis, on the magnitude of the surplus. The consumption requirement of the family constitutes the first charge on this surplus. Alternatively, of course, the consumption expenditure can be considered as an item of cost, in which case it will correspondingly reduce the surplus. The magnitude of the surplus depends not only on the profitability of the enterprise but also on the size of the enterprise. If the farm size is too small to provide full productive employment for the entire work-force of the family, either the cost of cultivation will be too high—if the entire consumption requirements of the family are considered as cost—or the expendable surplus will be less than the production surplus. As the recent Debt and Investment Survey by the Reserve Bank of India revealed, as much as 46·6 per cent. of the total borrowings by the farmers in 1961–2 was for 'household expenditure'. This can be considered as a legitimate item of borrowing, but only to the extent that it strictly constitutes the cost of cultivation, or, in other words, represents the wage equivalent of family labour utilized in cultivation. Any excess will be pure consumption credit, unmatched by corresponding production and would in fact be in the nature of unemployment benefit. As is well known, numerous farming units in India have a labour surplus. Under the circumstances, a major part of borrowing for household expenditure is unrelated to production requirements. To expect the credit agency to meet the *full* requirements of the borrower would be tantamount to making it responsible for sustaining unemployment. However, if what is suggested is that the credit agency should meet the full requirements only for *production* purposes, it will not be able to satisfy the *total* requirements of borrowing of those farmers whose household expenditure is not covered by legitimate return to the input of family labour into farming.[1] Thus the dilemma is real and emerges as much from the weakness of the agrarian structure as from the weakness of the credit structure.

Can one, therefore, conclude that a credit institution can fully assist an economically viable enterprise, but cannot by itself make an intrinsically non-viable enterprise viable? The preponderance of the money-lender as a purveyor of credit and the weakness of institutional credit in subsistence farming are not just a mishap of history, they are a part of the subsistence economy itself. The transition from money-lender credit to institutional credit has, therefore, to be a process simultaneous with the transformation of subsistence agriculture into commercial agriculture. Attempts to pre-date either cannot succeed.

[1] Readers may find it of interest to relate this discussion to the findings of Pilhofer's paper on this issue (Ed.).