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# ROLE OF COMMERCIAL BANKS IN AGRICULTURAL FINANCE —COMPETITION OR COEXISTENCE WITH CO-OPERATIVES

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## *Introduction*

An efficient system of agricultural credit is necessary if agriculture is to make its due contribution to national development. But credit will run to waste or its contribution will be limited unless it is supported within the rural sector by proper institutions which can spear-head development in all its aspects. So far agricultural credit in India has been marked by predominance of non-institutional agencies like moneylenders, traders, commission agents, landlords and similar individual lenders. Further, bulk of the credit has been for supporting production along traditional lines or for meeting consumption expenditures. Hence the vicious circle of low level of output, low income, low savings and low investments in Indian agriculture. Fortunately, this circle seems to have been broken and a break-through in agriculture has been taking place in certain parts of this country. However, this has thrown up a great challenge to our institutions financing agriculture. With the introduction of improved production technology in agriculture, the capital requirements of farmers both for making permanent investments and for meeting operational costs in the shape of improved seeds, fertilizers, and insecticides have far exceeded the supplies available. This paper examines (1) the criteria for a dynamic credit to agriculture, (2) the suitability of commercial banks in meeting these requirements and (3) the relationship of commercial banks with the existing credit institutions especially the co-operatives.

## *Desiderate of Dynamic Credit*

Agricultural credit in less developed countries has been like a dead weight on the farmer, because of its inefficient use and the defective nature of institutions serving them whereas dynamic credit is like a lever which would set in motion a process of development in agriculture, both quantitative and qualitative, resulting in improvement in output, income, savings and investment. The conversion of static into dynamic credit requires (1) an increase in the amount of credit available, (2) reduction in the cost of credit, (3) adjustment of credit terms to suit the convenience and repaying capacity of the farmer and (4) assistance in applying needed techniques and improvements in farm management. It is appropriate to examine the suitability of commercial banks in meeting these requirements.

## *Mobilization of Rural Savings*

An increase in the supply of credit requires attention to the problems of mobilization of rural savings and transfer of available savings into agriculture through different sources. International sources of finance for agriculture are limited because the per capita income as well as the proportion of income saved are usually lower in agriculture than in the rest of the economy. In spite of the

substantial increase in incomes in rural areas, savings in the rural household sector have not increased sufficiently. Between 1950-51 and 1962-63, for example, savings of the household sector as a whole increased by Rs. 572.6 crores or by 139 per cent, and of this increase, rural households contributed only Rs. 70.7 crores or 12.3 per cent. The overall contribution of the rural household sector to the total savings mobilized in the economy has also fallen from 29.3 per cent in 1950-51 to 14.2 per cent in 1962-63.<sup>1</sup> Similarly, the saving-income ratio of rural households has remained virtually constant around 2.3 per cent since 1950-51 as compared with the increase in the ratio for urban households from 7.3 per cent in 1950-51 to 1952-53 to 17.0 per cent during 1959-60 to 1962-63 (Table I).

TABLE I—AVERAGE SAVING-INCOME RATIOS—AGGREGATE SECTORWISE

	1950-51 to 1952-53	1959-60 to 1962-63
1. Government sector .. .. .	14.1	13.8
2. Domestic corporate sector .. .. .	39.6	40.7
3. Household sector .. .. .	3.5	6.7
(a) Rural household sector .. .. .	2.2	2.3
(b) Urban household sector .. .. .	7.3	17.0
4. Aggregate saving-income ratio .. .. .	5.0	9.3
5. Aggregate marginal saving-income ratio .. .. .	—	19.0

Source : Adapted from *Reserve Bank of India Bulletin*, March, 1965.

The relatively low saving-income ratio in rural households was partly due to stagnant agriculture and partly due to the absence of institutional agencies to mobilize savings. The low mobilization of savings in the rural sector has resulted in an acute shortage of finance for agriculture.

#### *Sources of Rural Credit*

As late as 1965-66 it was estimated that out of the total of Rs. 2,000 crores of credit requirements of agriculture in India, self-finance by the agricultural sector accounted for only Rs. 800 crores or a mere 40 per cent.<sup>2</sup> The remaining Rs. 1,200 crores have to come from outside sources. So far a major portion of this has come from the unorganized sector. Table II brings out the relative importance of different sources of rural credit in India during the period 1950-51 to 1961-62.

It may be seen that even though the proportion of credit supplied by institutional agencies has increased, the non-institutional agencies continued to supply a major proportion of the agricultural credit needs within the country. Now when the requirements of farm credit are substantially increasing the problem of institutionalizing rural credit has become all the more important.

1. *Reserve Bank of India Bulletin*, Vol. XIX, No. 3, March, 1965.

2. A. D. Gorwala, quoted by A. K. Narayan, in *Kurukshetra*, Vol. 16, No. 4, January, 1968.

TABLE II—SUPPLY OF RURAL CREDIT ACCORDING TO SOURCES : 1951-52 AND 1961-62

Credit agencies	Proportion of borrowings from each agency to total borrowings of cultivators in	
	1951-52	1961-62
(a) Institutional		
1. Government .. .. .	3.3	2.6
2. Co-operatives .. .. .	3.1	15.5
3. Commercial banks .. .. .	0.9	0.6
Total .. .. .	7.3	18.7
(b) Non-institutional		
1. Relatives .. .. .	14.2	8.8
2. Landlords .. .. .	1.5	0.6
3. Agricultural moneylenders .. .. .	24.9	36.0
4. Professional moneylenders .. .. .	44.8	13.2
5. Traders and commission agents .. .. .	5.5	8.8
6. Others .. .. .	1.8	13.9
Total .. .. .	92.7	81.3
Grand total .. .. .	100.00	100.00

Source : Report of the Committee of Direction, All-India Rural Credit Survey, Vol. II—The General Report, Reserve Bank of India, Bombay, 1954 and *Reserve Bank of India Bulletin*, Vol. XIX, No. 9, September, 1965.

However, the past performance of the co-operatives with respect to mobilization of deposits and recoveries of loans hardly gives room for any hope that they will be able to cope with the new needs at least in the near future. In 1963-64, taking the primary co-operative credit structure, overdues totalled Rs. 77.31 crores and formed 22.5 per cent of the loans outstanding. In the same year, total deposits stood at Rs. 26.06 crores or only 5.9 per cent of their working capital.<sup>3</sup> Therefore if the institutional credit to agriculture is to be improved, commercial banks have a crucial role to play.

#### *Advances of Commercial Banks*

However, it may be noted that during 1950-1965, while the commercial banks registered marked improvement in their business both in terms of mobilization of deposits and making of loans and advances, their proportionate contribution to agriculture has declined as may be seen from Table III.

During 1950-1965, aggregate deposits of all scheduled banks have increased by 235 per cent from Rs. 881 crores to Rs. 2,950 crores and their advances rose by 371 per cent from Rs. 498 crores to Rs. 2,347 crores. While the increase in industrial advances has been of the order of 863 per cent and that of commercial

3. *Co-operative News Digest*, Vol. XIX, No. 3, March, 1968, Agricultural Credit Department, Reserve Bank of India, Bombay.

advances at 219 per cent, their advances to agriculture have declined from 2.37 per cent to 0.2 per cent of total advances. This was partly due to the Government policy which maintained agricultural finance within the exclusive domain of co-operatives. The decline in advances to agriculture is rather disconcerting

TABLE III—PURPOSEWISE ADVANCES OF ALL SCHEDULED BANKS  
(rupees in crores)

Sector	1950-51 Amount	Per cent of total	1965 Amount	Per cent of total	Per cent increase or decrease over 1950-51
Industry .. .. .	156.77	31.5	1,510.00	64.3	863.19
Commerce .. .. .	179.39	36.0	573.00	24.4	219.42
Financial .. .. .	80.30	16.1	77.00	3.3	—4.11
Agricultural .. .. .	11.52	2.3	5.00	0.2	—53.60
Personal and Professional .. .. .	39.13	7.9	121.00	5.2	209.22
Others .. .. .	31.30	6.3	61.00	2.6	94.89
Total .. .. .	498.40	100.0	2,347.00	100.0	370.91

Source : Indian Conference on Research in National Income : Papers on National Income and Allied Topics, Vol. I, Asia Publishing House, Bombay, 1965, p. 174, and *Reserve Bank of India Bulletin*, Vol. XXI, No. 1, January, 1967.

in the light of the fact that the number of offices of commercial banks in the rural and semi-urban areas has increased from 1,563 to 2,465 over the period from 1951 to 1966. Opening of branches in rural areas was only the beginning of ruralization of banking. The average credit-deposit ratio of 743 branches of State Bank of India for which figures up to June, 1967 were available was low at 29.5 per cent. It was because of this low credit-deposit ratio losses were incurred in branch expansion which had to be recouped from the Integration and Development Fund.<sup>4</sup> Furthermore, this has resulted in a certain amount of perverse flow of funds from rural areas to the metropolitan centres.

### *Social Control of Banks*

Now the situation seems to be changing. In pursuance of the scheme of social control of banks by the Government, a National Credit Council has been set up to rectify the sectoral bias in the commercial banks' advances. It was intended to be a forum where the relative claims of different sectors could be discussed and priorities determined. However, it appears that the National Credit Council is presently engaged in allocating the new accretions of deposits rather than rectifying existing sectoral imbalances. Thus the problem of credit allocation has been related to whatever amount is left over from the normal accretion of deposits which is estimated at Rs. 400 crores per year. After meeting liquidity requirements (cash plus investment in authorised securities), this amount comes to about Rs. 290 crores or so to be distributed according to new priorities. In this, the share of agriculture comes to Rs. 35 crores which is roughly 12 per

4. Press Conference by V. T. Dehejia, Chairman, State Bank of India, *The Economic Times*, Bombay, 19th March, 1968.

cent.<sup>5</sup> This obviously indicates that what to speak of rectification of previous sectoral imbalances, the allocation proposed for agriculture falls far short of requirements. It is, therefore, imperative for the National Credit Council to address itself to the vital task of allocating bank credit on the basis of certain rational criteria such as Plan priorities, contributions to national income and employment, requirements of balanced growth, etc.

The field of agricultural finance being vast and complex as well as new, banks rightly thought that individually it would not be possible for them to make a meaningful impact on the problem. The commercial banks have, therefore, set up an Agricultural Finance Corporation with a view to participating actively and extensively in the development of agriculture. In this context certain questions necessarily emerge, *viz.*,

- (1) Will the commercial banks be able to mobilize sufficient funds and administer the same at a lower cost as compared to other agencies ?
- (2) Will they be able to cater to all types of credit—short, medium and long-term—required to provide the much needed dynamism to our agriculture ?
- (3) Will there be any need for demarcation of functions between the co-operatives and commercial banks ?

#### *Deposit Mobilization by Commercial Banks*

The problem of agricultural credit in India is not merely one of inadequate resources, but one of proper mobilization and channelling of the same to productive investments. Unfortunately, data regarding mobilization of rural savings are not readily available. However, in the context of the break-through in production technology and continually rising farm incomes, there is every reason to believe that the savings potential is large in the rural sector. Therefore, if the commercial banks can attract rural deposits on the required scale, the supply of agricultural credit can be increased without straining other sectors of the economy. The commercial banks seem to have found an answer to this problem by the extension of branch banking facilities in rural areas. The idea of 'one man bank' mooted by some commercial banks seems to have caught on. Recently on the occasion of the opening of the third one man village office, the State Bank of Mysore released some details of deposit accretion at the two such offices started in 1965 and 1966. In Anandapuram office, for example, the bank was able to increase its deposits by more than three-fold from Rs. 0.82 lakh to Rs. 3 lakhs within 3 years. Similarly, in the Konanur branch the deposits grew from Rs. 2.40 lakhs in 1966 to Rs. 4.25 lakhs in 1967.<sup>6</sup> Since operating at lower cost is the *sine qua non* of rural banking, the one man office idea will go a long way in extending banking facilities to rural areas at minimum cost. Similarly, the suggestion (of the Canara Bank) to engage itinerant agents for mobilizing rural savings and the new scheme of "Jana Priya Deposits" are laudable. It is an adoption of the term deposit scheme to suit rural conditions and is so devised that

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5. Social Control of Banks, *The Economic Times*, Bombay, 21st July, 1968.

6. Editorial on Rural Banking, *Southern Economist*, January, 1968.

the depositor does not have to call on the bank to make deposits or to execute papers. Here is the case of the bank going to the customer and it marks a step in the right direction.

### *Types of Commercial Bank Finance to Agriculture*

The most crucial issue regarding the entry of commercial banks into agricultural credit is the consideration as to the type of finance that they are most suited to undertake. To study the directions in which the commercial banks are investing their funds in agriculture, information was collected from a few prominent commercial banks. Table IV shows that about 33.50 per cent of the loans have been made to the State Electricity Boards and about 28.56 per cent of their loans have gone to finance processing and marketing, indicating banks' preference for safe and secure investments. This was but natural. As custodians

TABLE IV—PATTERN OF COMMERCIAL BANK ADVANCES TO AGRICULTURE

Purpose	Percentage
1. Production .. .. .	14.90
2. Land improvement .. .. .	1.17
3. Pump-sets and tube-wells .. .. .	5.40
4. Rural electrification .. .. .	33.50
5. Agricultural machinery .. .. .	2.90
6. Dairy and poultry .. .. .	3.56
7. Processing and marketing .. .. .	28.56
8. Plantations .. .. .	6.08
9. Cold storage .. .. .	3.92

*Source :* Based on data collected from some prominent Commercial Banks.

of depositors' moneys, these banks could hardly be expected to risk their capital in uncertain and long-term investments. Hence their lending to agriculture had to be selective. It is also evident from the table that short-term production credit ranks low (14.9 per cent) in their scheme of priorities on account of the high cost of credit administration due to the following limiting factors :

- (a) Average size of production unit in agriculture is small.
- (b) Farms are widely scattered geographically.
- (c) Natural hazards inherent in farming operations and lack of crop insurance.
- (d) Securities which the small farm units can offer do not meet commercial bank requirements.



Despite the above limitations, the entry of commercial banks into short-term production credit is certainly a trend to be welcomed as it will give a business orientation to our agriculture. In order to be eligible for commercial bank loans, the farmers will have to develop business attitude towards farming, keep proper records and follow production practices which are economically sound. However, in order to be effective in production credit, the banks will have to be equipped in terms of trained staff to appraise the creditworthiness of farmers, to prepare farm production plans, and to supervise the utilization of credit. Combining of such extension activities with the provision of credit will give a strong positive inducement to improvements in farming techniques, institutions and organization and to changes in attitudes.

#### *Competition or Coexistence with Co-operatives*

However, the entry of commercial banks into short-term production credit need not constitute any threat to the co-operative agencies, rather these banks will provide the much needed competition to our agricultural co-operatives and induce them to reorientate their work on business principles. In spite of their best intentions, the former agency is not likely to make any big impact on operational credit as many of the cultivators especially small ones will not be able to meet the rigid security requirements of commercial banks.

#### *Reorganization and Strengthening of Co-operatives*

On the other hand, village co-operatives have sufficient experience in providing personalised services to small and medium sized farmers. Further, the co-operatives are now providing a package of services—credit, inputs, marketing and processing facilities. In spite of their shortcomings, the loans outstanding at the level of primary agricultural credit societies increased more than seven-fold from Rs. 49 crores as on June 30, 1955 to Rs. 371 crores as on June, 1965. Therefore, instead of replacing an established agency in short-term agricultural finance, there is an urgent need to strengthen the co-operatives and integrate them with marketing and processing co-operatives which might provide more suitable negotiable securities to the commercial banks. In this connection, it is suggested that the co-operatives should be reformed and reorganized to make them immune from political influences. Perhaps the best way to depoliticise the co-operatives would be to reduce the powers of the Board of Directors and to make them purely advisory and thus to enlarge the powers of the Executives to facilitate prompt decision-making. The co-operatives thus shorn of their political bias and manned by a cadre of trained staff could function on the patterns of United States Farmers' Home Administration catering primarily to the needs of small and subsistence farmers until such time when they become economically viable to receive loans from any other institutional sources. Thus there need be no rigid demarcation of functions between the spheres of operation of the commercial banks and the co-operatives. The former should not be prohibited from granting even short-term production loans wherever it is feasible, but it seems that the commercial banks will confine their operations to medium and long-term loans to the more progressive and affluent classes of cultivators because of the ready availability of security.

*Indirect Finance to Agriculture*

However, a more promising avenue for them to explore seems to be active assistance to co-operatives and other institutional agencies engaged in agricultural credit, marketing, distribution or processing such as the Agricultural Finance Corporation, the Agricultural Refinance Corporation, the Food Corporation, the National Seed Corporation and Agro-Industrial Corporations. They can be of assistance to agriculture by (i) contribution to share capital of these agencies, (ii) investment in their securities and debentures, (iii) advancing loans to these agencies, and (iv) providing them remittance facilities.

Such an approach would avoid duplication and reduce the cost of servicing loans. Further, the routing of loans by commercial banks through co-operative and other institutional agencies would also minimize the problems of co-ordination as the co-operative agencies could establish a liaison with these institutional agencies right from the national level to the State and district levels.

*Conclusion*

The problem of agricultural finance in India is not merely one of insufficient supply but also ineffective institutions to induce qualitative improvements in our agriculture. The commercial banks known for their initiative and dynamism are expected to fill this gap. Although they should not be prohibited from direct finance to agriculturists even for short-term, a more promising avenue for them to explore is to augment the resources of co-operatives and other agricultural credit and marketing institutions. Thus, the commercial banks need not supplant the co-operatives but supplement their efforts to transform Indian agriculture.

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INSTITUTIONAL FINANCE FOR AGRICULTURAL DEVELOPMENT:  
SUITABILITY OF CO-OPERATIVES IN THE NATIONAL INTEREST

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With the decision of the Government of India to enact social control on commercial banks, the suitability of commercial and co-operative banks for giving agricultural finance is being discussed frequently at all levels. Agriculture is our main industry and needs highest priority. In this context, the performance of commercial banks was judged and found very poor. As on 31st March, 1967, credit to agriculture by commercial banks amounted to Rs. 56.64 crores and formed only 2.1 per cent of their total advances. These banks are now being asked to give more finance to agriculture. At present finance to agriculture mainly comes from the co-operative banks, Government in the form of *taccavi* loans and the

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\* Views are personal.