Ind. Jn. of Agri. Econ.
Vol. 50, No. 3, July-Sept. 1995

Reforming Agriculture – Real and Financial

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That agricultural reform is a concomitant of the new economic policy is being increasingly realised and examined. Both in demand and supply management agricultural production, trade, and finance have assumed importance, particularly in the context of the General Agreement on Tariffs and Trade (GATT) agreement. Under this imperative of reform, the real and financial aspects have to be matched and analysed simultaneously in order to maintain stability and sustained growth. Here we juxtapose the required reform of agricultural finance against the emerging change in agricultural production and trade. The financial circuit has to fit in the production circuit so that efficiency and equity are balanced. In Section I of this paper the aspects of new economic policy of agriculture and the direction of emerging agricultural production are examined; in Section II the impact of financial reform on agriculture and credit requirement is analysed; in Section III the reformulated financial structure is proposed corresponding to the change in production aspect in the agricultural sector; conclusions are drawn in Section IV.

I

NEW ECONOMIC POLICY AND CHANGING AGRICULTURE

Macro economic structural reform programme has envisaged deregulation of industries and trade, reduction of public sector and privatisation of financial institutions. This policy has both negative and positive impact on agriculture. The negative aspect of reduction of government subsidies in fertiliser and other inputs has important effect on farmers in general and the marginal farmers in particular. The rising cost of production as a result of this along with the reduction of subsidies in public distribution system accentuates the intensity of poverty and deprivation.

The negative impact of financial sector reform for agriculture is still more direct (Krishnaswamy, 1994; Gulati and Sharma, 1994). The recommendation of the Narasimham Committee (Government of India, 1991) to reduce the priority sector lending by commercial banks to 10 per cent of the total lending is contrary to the bank nationalisation objectives. Delicensing of branch expansion as well as reduction of priority sector lending by commercial banks is thus a reverse process of social banking started with nationalisation. Much of the progress of small farm extension and progress in foodgrain production have been due to special privilege offered to this section of farmers by the banks. Under the new economic policy subsidies and directed credit to agriculture have been withdrawn and farm finance has become restricted to the market-determined agents or big farmers at market-determined rate.

The positive aspects of trade liberalisation and Dunkel agreement under the World Trade Organisation (WTO) are that more agricultural exports as well as import would be possible provided the necessary conditions of production and manufacturing are made available (Tarkunde, 1994; Bhagwati, 1994). It is expected that under the liberalised trade regime of WTO, the country would be able to export more to the world market. It has, therefore, opened

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a new dimension in our largely subsistence farming. Commercialisation of agriculture calls for a radical change in production, processing, marketing and diversification of Indian agriculture. In the new perspective of liberalisation perhaps the biggest challenge has come before Indian agriculture which required a determined effort to introduce radical change. Indian agriculture is now to meet the double challenge - that of growing demand for food and industrialisation within the country and that of external demand and export.

In the context of liberalised open economy Indian agriculture requires huge investment for infrastructure, irrigation and watershed development, for supply of electricity, fertiliser and appliances, for diversification, processing, storage and marketing and for training, research and development. Above all, it requires a drastic institutional reform on the basis of which the overall transformation plan of agriculture has to be formulated.

Until now Indian agriculture experienced only fragmented transformation under green revolution. It was crop-specific and region-based development. In other parts of the country, particularly in West Bengal, land reform could bring about a quiet revolution in agricultural production different than the green revolution approach. A generalised approach to agricultural development based on land reform and aimed at farm and non-farm transformation in rural life and poverty alleviation has not yet been formulated (Rao, 1994).

Under the new economic policy export of farm products has become bright according to the multilateral trade rule of WTO. Indian agricultural production has to be increased substantially and the country has all the resource endowment for that. The rapid agricultural growth experienced during the green revolution is waning. Achieving food security and eradication of poverty are the primary objectives of structural reform. Food production has made tremendous progress, increasing from 72 million metric tonnes in 1965-66 to 185 million tonnes in 1994-95. On the other hand, foodgrain imports were on an average 6 million tonnes per year from the mid-1960s to the mid 1970s but its import has become negligible now. Foodgrain stocks rose from 2.2 million tonnes in 1965-66 to 31 million tonnes in 1995. However, this progress neither indicates the peak nor sustainability. Capital formation in agriculture is declining and the real investment in agriculture, as stated in Table I, is not at all satisfactory.

TABLE I. REAL INVESTMENT IN AGRICULTURE (AT CONSTANT PRICES 1980-81)

(Rs. crores)

Period (1)	Public (2)	Private (3)	Total (4)
Seventh Plan			
1985-86	1,520	2,805	4,325
1986-87	1,425	2,586	4,011
1987-88	1,458	2,956	4,414
1988-89	1,362	2,985	4,347
1989-90	1,156	3,197	4,353
Annual Plans			
1990-91	1,153	3,440	4,593
1991-92	1,001	3,496	4,497
Eighth Plan			
1992-93	1,065	3,552	4,617
1993-94	1,074	3,621	4,695

Source: Reply to Parliament Question.

The International Food Policy Research Institute (IFPRI) observed that annual increment to gross capital formation in agriculture is now lower than in the early 1980s. The current agricultural policy must taken note of the following changing scenarios.

(i) As stated above, the capital formation in agriculture is slowing down. (ii) Decline in public investment is not compensated by private investment which is also moderate. (iii) A major part of agricultural subsidies is going for inputs like fertilisers, electricity, irrigation and credit, rather than productivity-enhancing investment; the share of input subsidies in public expenditure increased from 44 per cent in the early 1980s to 83 per cent by 1990. (iv) Higher economic growth as well as increase in population growth will increase the demand for food. (v) Moreover, the demand structure itself is changing; the demand for higher-valued food, vegetables and fruits is increasing and is greater than the basic cereal staples. (vi) International export of the processed food and high-valued products is increasing. All these changes would mean that there is likely to be demand-supply mismatch which has to be resolved by increasing agricultural investment (Bhalla, 1995).

As stated above, Indian agriculture had undergone technological change at different rates across regions and among different crops, and the rapid growth in wheat and rice production resulted in substantial increase in marketable surplus of those items. But that is only a partial growth. In order to make this advance a sustainable growth and to ensure a growing balance between supply and demand in an open economy perspective, a generalised approach to agricultural development is important. This generalised approach to agricultural development will encompass the farm and non-farm activities, organisational change, infrastructure and environment development. This approach also calls for a generalised rural financial structure which is discussed in the next section (Banerjee, 1994, 1995).

A major bottleneck in agricultural development is infrastructure and irrigation. If the subsidies on irrigation, fertiliser, power, credit are withdrawn, which is a part of the programme of liberalisation and which is a part of the implications of the GATT agreement, then the development of these facilities will depend on the private sector. It therefore requires the development of a broad-based rural financial structure.

II

CREDIT REQUIREMENT

Rural financial structure has to be redesigned. The new economic policy has reduced the flow of credit to the rural sector by reducing the directed credit as also by relaxing the compulsion of branch expansion in the rural areas. With the growing demand for credit in the new direction of agricultural activities as stated above, the financial structure has to be re-organised. The flow of credit at low cost to the priority sector has been the motto of nationalisation. Now that regulation has been relaxed, the interest rate will no longer be lower than the market rate. Thus the volume of credit has been reduced and the cost of capital has become high both of which are the immediate results of the new economic policy.

The outcome of recommendations of the Narasimham Committee is the growing void in the rural financial structure and the resurrection of the traditional mode of finance - the neo-moneylender, indigenous banker and co-operatives, all of which are historically tested inadequate and inefficient credit institutions. The erosion of Regional Rural Banks (RRBs) as also the co-operatives has been a disappointing experiment for different reasons which have to be corrected and remodelled consistent with the market economy approach now being implemented in our country. The credit gap in the rural sector will be still glaring if we take the potentially positive effect of reform in agriculture, as stated above. Production diversification and infrastructure development in agriculture have been slow. Now that the manufacturing of agricultural products is encouraged for export and growing internal market, large private investment, domestic and foreign, is invited in this sector. The rural financial structure, as it stands at present, is inadequate to meet the gap.

An important aspect is the rural saving and investment relation. The rural financial institutions particularly the RRBs and the branches of commercial banks in many cases have done commendable service to the community, particularly in the hill and tribal areas. However, the overall resource mobilisation of these agencies is not satisfactory. The trends and progress in banking indicated poor credit-deposit ratio of the rural branches of commercial banks and RRBs. When the reform measures restricted the credit flow in the rural sector the credit crunch has become acute. This will be further critical when larger investments in medium-term and long-term agricultural infrastructure begin to come up.

The present financial requirements in agriculture are not simply concerned with a few crops and inputs as in green revolution. Economic reform and deregulation of trade and investment have brought about greater opportunity of wider transformation of the rural economy. Neither the RRBs nor the co-operative banks are capable of supplying the necessary credit for this emerging transformation, and commercialisation of agriculture.

Refinancing by the National Bank for Agriculture and Rural Development (NABARD) has partly energised the co-operative banks and the RRBs. The extent of such refinancing facilities from the apex body has been substantial both in respect of crop loans and medium-term and long-term loans. Under the new changing character of agricultural production and trade, the latter type of loans will increase substantially. The commercial banks' role in this regard in the rural sector is unsatisfactory, given the nature of capability and management of the RRBs and commercial banks. In the near future public investment and private investment in agriculture have to the enhanced with the change of the rural banking.

III

REMODELLING RURAL FINANCIAL STRUCTURE

As referred to above, the financial reform programme as envisaged in the Narasimham Committee Report failed to take note of the emerging possibilities of agriculture, both real and financial. Commercialisation, marketisation and globalisation of agriculture have opened up enormous possibilities, although apparently this will appear as starving the agriculture of concessional finance and affecting the marginal farmers.

What is important is remodelling of rural financial structure along with the transformation of the production relation in agriculture. While the land reform and co-operativisation will bring about a new production relation in place of the earlier feudal structure, and will increase the demand for credit for infrastructure, irrigation, seed-fertiliser and inputs, the remodelled financial structure should be such as to extend such credit to individual and collective production units. In this process of transformation just as co-operatives, collective and participatory organisation of production and marketing are essential to ensure welfare and efficiency, similarly in the financial sector also consolidated organisation and cluster approach of operation are essential.

A consolidated financial structure will avoid multiplicity of agencies which are very often inefficient and ineffective. Such inefficiencies lead to ultimate decline and decay of the institutions; the RRBs and co-operatives are our new and old examples in this line. This indicates the imperatives of rural financial restructuring. The rural branches of commercial banks is an addition to that genre.

We consider a three-tier rural banking structure. Considering the advantages of local character of the RRBs and the co-operative banks, this should be merged together. This is basically in line with the recommendations of the Rural Credit Enquiry Committee which suggested long ago the merger of successful co-operatives with rural branches of commercial banks in order to infuse local informal qualities to the commercial banks while retaining their commercial efficiency. The merger of co-operative banks and RRBs will develop into a viable rural financial institution. Both in respect of mobilisation of resources and lending operation, this new financial set-up - be it called Regional Rural Co-operative Banks (RRCBs) - will be more strong and capable of efficient management. While retaining the advantages of the local character, the RRCBs will have strength and organisational and managerial skills of the commercial banks. The argument follows in the line of the Narasimham Committee. "While competition should be a relevant factor in the business of banking, in the particular circumstances of rural banking this proposition needs to be" examined. "Given the credit gap which exists in rural community, and the distance still required to be covered before the rural banking needs are fully taken care of, the need is to establish a viable banking structure which could effectively meet rural credit needs" (Government of India, 1991). The RRCBs perfectly suits the whole gamut of the recommendation of the Narasimham Committee.

The second leg in the three-tier rural financial structure is the Land and Infrastructure Development Banks (LIDBs), by conversion of the present Land Development Banks. Since in the new economic policy the medium and long-term loans have become more important for rapid development of transport, irrigation, watershed development, these new LIDBs will perfectly suit the required financial structure and the credit gap, as examined by us above and as referred to by the Narasimham Committee. As a matter of fact, these developments are land-augmenting and labour-augmenting as some of these long-term investments improve the capability of labour force also. That this type of LIDBs is required to meet the gigantic challenge of infrastructure development in both the hill and plain terrain as well, is substantiated by the Central Government's proposal to build up an Infrastructure Development Bank for the North-Eastern States in the Budget of 1995-96.

The rural branches of commercial banks should be rationalised. As the Committee suggested, with delicensing of branches the commercial banks "should have the freedom to swap their rural branches with those of other banks which would facilitate banks which have fewer rural branches in certain districts to cede them in favour of those banks which have a larger presence" (Government of India, 1991).

However, this should not necessarily bloom into a new set of 'subsidiaries' of national banks in the rural sector, as the Committee suggested. The experience of State Bank subsidiaries is not at all promising. These rationalised rural branches of commercial banks will serve as a link between the two-tier rural financial structure, namely, RRCBs and LIDBs as proposed above, and the national commercial banks. Thus instead of a number of parastatal parasitic agencies we will have three strong agencies which will rationalise the rural financial activities.

The operational classification of this three-tier structure in agricultural finance can be easily conceived. While the infrastructure bank (LIDBs) will look after the long-term development functions, the RRCBs will particularly be engaged in short-term production activities and other kinds of employment and income generating activities. The integrated rural branches will take up the trading and money market activities and investments.

While it is true that, given our experience of age-old co-operatives and the new RRBs, it is the efficiency and not the institutions which is important for rural financial institutions, the proper structural renovation consistent with capital adequacy principles is equally important for rural and agricultural finance. Directed credit, irrational subsidisation, corruption, politicisation are some of the major factors which made all financial institutions, rural and urban, equally parasitic. If the co-operatives or the RRBs are working at loss, the major nationalised banks are equally in the red. Efficiency norms will have to be applied equally in all sets of banks, rural or urban.

This brings us to the application of market principles in rural banking. Interest rates in the market reflect the availability and the cost of capital. While some kinds of rural activities of artisans and the marginal farmers need special treatment in a collective way, credit to the intra-marginal farmers and other profitable activities in agriculture must reflect the cost of capital. Since agricultural finance is largely class banking, the entire rural banking, as far as possible, should be based on group or cluster concept in which commodity contingent, class contingent and market contingent prevail. The application of this principle in rural lending of Grameen Banks has been highly successful in Bangladesh and some other countries as well.

This positive step in agricultural finance as a response to the new thrust in agriculture will be complete with the change of rural money market. The centre-piece of rural money market is the NABARD which was supposed to spearhead the rural and agricultural transformation through the RRBs and co-operatives. The farmer remained mainly the refinancing agency and the latter agencies have, as stated above, become perpetually parasitic. Therefore, neither real nor financial thrust in agriculture did take place. With increasing public and private investment and non-farm manufacturing activities which are supposed to make a leap under the new economic policy, the network of RRCBs, LIDBs and amalgamated rural branches of commercial banks will, under the NABARD, provide a financial network of rural money market based on diversified rural transactions. The old dichotomy of Indian money market will fade out and a vastly expanded dynamic financial structure will develop enabling the intersectoral movement of fund rapidly and at low cost.

IV

CONCLUSIONS

Reforming agriculture is yet to take shape in India and there has been only a fractional development in selected crops and in selected regions. It is now time for an integrated agricultural revolution comprising green revolution, white revolution and all round development of farm and non-farm activities. The remodelled financial infrastructure will match the real infrastructure in agriculture developing under private and public initiative as a logical sequence of new economic policy.

The new economic policy of liberalisation and the GATT agreement have brought about a challenge for our agriculture to provide food security and employment for the growing population as well to earn export surplus for rapid growth of the economy. The negative aspect of the new policy with regard to agriculture is the reduction of subsidies on fertiliser, electricity, irrigation, credit and public distribution. Price, trade and distribution will be based on market principle. The cost of these inputs will increase and this will whip up the scourge of inflation and poverty. The impact of the negative aspect of Dunkel agreement will be on scientific innovation and research in agriculture and other areas of technical adaptation.

The positive aspects of the new policy is the emergence of market principle in our otherwise parasitic subsistence system. Access to world market has brought about an opportunity for diversification of Indian agriculture. In spite of competition and protection, the GATT agreement and WTO rules have shown a new direction for Indian agriculture to become a leading sector for economic development.

However, to realise this new opportunity of globalisation three steps are urgent - real, financial and institution. Substantial investment in infrastructure, power, irrigation and research is the first set of work. A simultaneous radical step for remodelling the rural financial structure is essential The three-tier rural structure encompassing RRCBs, LIDBs and rationalised rural branches of commercial banks is consistent with the spirit of the committee for financial reform. Such structural and operational redirection of rural financial institutions under the NABARD will usher in a vibrant rural money market based on decentralised principles. The strong third step is the land reform and environmental protection. The new economic policy has made it imperative for a generalised approach to agricultural reform.

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