Chapter 4: Rural Credit

The present crisis in the agricultural sector in Andhra Pradesh brings into focus the lacunae in the rural credit system, which have added to the woes of the farmers. Most of the rural credit in the state is still supplied from non-institutional sources, and it is estimated that formal credit meets less than 30 per cent of the credit requirements of the farmers. It is very important that the credit requirements of agriculture be assessed and met by the formal sector, and that farmers are liberated from enforced dependence upon private moneylenders.

Subsequent to financial liberalisation in the 1990s, there has been a significant deceleration in the growth of bank credit, particularly from commercial banks to rural areas. Also notable is the relative fall in proportion of bank credit flowing to the priority sectors, especially agriculture. The impact of the slowdown in rural banking has fallen disproportionately on poor and small borrowers.

It may be noted here that large-scale survey data on the situation of rural debt are outdated, as the results of the All-India Debt and Investment Survey 2001-02 have not been published. Although, there are no large scale survey data available for the 1990s, village studies indicate that non-institutional or informal credit is the main source of credit for the large majority of rural households today. To illustrate, a recent survey of eight villages found that only 20 per cent of all agricultural loans were provided by institutional sources (Table 4.1 below). The study also found the share of institutional sources in total loans to be 20 per cent. The informal sector thus dominates the village credit market, and it is clear that interest rates charged in the informal sector remain high (24 to 36 per cent per annum).

Table 4.1: Source-wise Interest Charges on Agricultural Loans in Select Villages of Andhra Pradesh

	Rate of Interest	Institutional Loans		Non-Institutional Loans		Total Loans	
		Number	Per cent	Number	Per cent	Number	Per cent
	<12%	4	1.75	0	0	4	0.04
	12%	112	49.12	14	1.51	126	10.94
	13 to 23%	73	32.02	3	0.32	71	6.16
	24%	31	13.59	370	40.04	401	34.81
	36%	8	3.5	479	51.84	487	42.27
	48%	0	0	5	0.54	5	0.04
	60%	0	0	37	4	37	3.21
	>60%	0	0	16	1.73	16	1.39
Total		228 (19.79)	100	924 (80.21)	100	1152 (100)	100

Sources: N.Shyam Sundar (2003) and R.S.Rao and M. Bharati (2003)
Note: Figures in parenthesis refer to the share in the total number of loans.

Formal agricultural credit is disbursed through a multi-agency network consisting of Commercial Banks (CBs), Regional Rural Banks (RRBs) and Cooperatives. Among formal institutional agencies, commercial banks play a dominant role, contributing about 74 per cent of total institutional credit to the rural sector. The state is served by 48 commercial banks with 4041 branches. Out of the total branches, only 1531 (38 per cent) are rural branches. Co-operative banks and RRBs account for about 15 per cent and 11 per cent of total rural institutional credit respectively.

Commercial banks

The share of agriculture in the total credit flow of commercial banks has been declining over the last few years and it came down from 70 per cent in 1998-99 to 50 per cent in 2002-03. Within agriculture, the share of crop loans has declined from 58 per cent to 43 per cent during the period 1998-99 to 2002-03, while the share of agriculture term loans disbursed has declined from 12 per cent to 7 per cent. The share of agriculture in actual disbursement (ground level credit flow) has declined from 80 per cent in 1993-94 to 50 per cent in 2002-03. Apart from lending less than the stipulated target of 18 per cent, many commercial banks are shying away from agriculture and priority sector lending by resorting to the soft window option of investing in the RIDF window of NABARD.

The credit-deposit ratio for rural bank branches in Andhra Pradesh declined from 80 per cent in 1990 to 62 per cent in 2002. Even now, many commercial banks are not adhering to the stipulated 60 per cent credit-deposit (CD) ratio: in seven districts the CD ratio has been below 50 per cent during the year 2004 and in ten districts it has been below 60 per cent. Around 57 per cent of bank agricultural credit goes to the coastal region, 13 per cent to Rayalaseema and 29 per cent to Telengana. In addition to the regional disparity in credit disbursal, the banks, increasingly under the sway of a liberal financial regime, appear to be reluctant to lend to small farmers. The policy is oriented to the logic that it is better to lend to a small number of large borrowers than to a large number of small borrowers. Further, tenant farmers are entirely outside the ambit of the formal credit market, due to lack of documents that recognise their rights as cultivators.

Table 4.2: CD Ratio in different districts as on June 30, 2003

District	Public Sector Banks			
	Offices	**Deposits**	**Credit**	**CD Ratio**
Adilabad	73	1035.37	402.17	39
Ananthapur	117	1570.3	732.01	47
Chittoor	157	2876.91	1112.4	39
Cuddapah	89	1156.49	548.32	47
East Godavari	286	2732.3	2092.94	77
Guntur	254	2652.6	2289.6	86
Karimnagar	127	2163.19	790.63	37
Khammam	83	915.49	364.6	40
Krishna	288	2963.98	2030.92	69
Kurnool	136	1334.65	805.54	60
Mahaboobnagar	124	914.16	558.6	61
Medak	93	893.87	1543.89	173
Nalgonda	103	805.48	649.44	81
Nellore	127	1225.6	899.03	73
Nizamabad	127	1195.43	650.2	54
Prakasam	164	1344.61	969.62	72
Rangareddy	156	2863.64	1527.29	53
Srikakulam	79	750.01	446.26	60
Vishakapatnam	207	4114.18	2845.41	69
Vizianagaram	70	619.47	281.28	45
Warangal	136	1481.02	766	52
West Godavari	233	1920.23	1780.91	93
Grand Total	3229	37528.98	24087.06	65
Coastal Districts	1708	18323	13636	72
per cent	53	49	57	
Rayalaseema	499	6938	3198	48
per cent	15	18	13	
Telangana	1022	12268	7253	68
per cent	32	33	30	
Drought Prone Districts	1374	16461	9660	64
per cent	43	44	40	

Source: RBI Banking Statistics - Quarterly Handout - March, 2004

Term lending has fallen short by about 50 per cent of the target in the past three years, when the peasants in the state suffered acute water shortage for crops. This highlights the gross failure of the institutional credit mechanism. It is obvious that institutional credit failed the peasantry at the time when it was needed most. The scale of finance has typically been very low, much lower than the prescribed limit for crop loans, as described in Table 4.3 which indicates that the average for the state as a whole was less than Rs. 10,000 per loan and in some districts like Mahbubnagar and Vizianagram it was less than Rs. 5,000.

Table 4.3: Average Disbursement of Crop Loans to Cultivators in A. P

District	Amount Disbursed (Rs.in Crores)	No. of Cultivators (1991 Census Data)	Average disbursement per cultivator in Rs.
W. Godavari	815	219955	37053.03
E. Godavari	681	249094	27339.08
Krishna	653	243322	26836.87
Guntur	729	384353	18966.94
Prakasham	528	337228	15657.06
Nellore	283	217978	12982.96
Kadapa	315	272545	11557.72
Kurnool	382	331821	11512.23
Khammam	246	261090	9422.04
Nizamabad	302	326904	9238.19
Anantapur	428	490385	8727.84
Warangal	268	413934	6474.46
Chitoor	342	528514	6470.97
Karimnagar	273	457958	5961.25
Adilabad	173	294493	5874.50
Ranga Reddy	148	256505	5769.87
Medak	225	419894	5358.50
Vizak	251	477449	5257.11
Nalgonda	213	416879	5109.40
Srikakulam	167	333823	5002.65
Vijayanagaram	173.83	368490	4717.36
Mahaboobnagar	251	586403	4280.33
Total	7846.83	7889017	9946.52

Source: Statistical Abstract of AP, Directorate of Economics and Statistics, 2003.

The interest rates in respect of agricultural advances have been higher than in the case of many other sectors. Banks have not designed efficient procedures for lowering the interest rates for this section of borrowers and there have been few innovations designed to cope with the special demands of agriculture. Nor are interest rates uniform across banks.

The fundamental issue in agricultural credit is that of the heightened risk perception of banks, which is manifest in their asset allocation policies. However, a comparison of levels of non-performing advances (NPAs) reveals that the NPAs arising from agricultural advances are less than those of other sectors.

The rural operations of commercial banks have always been under staffed. The voluntary retirement scheme has brought down the staff strength even further, impacting rural branches adversely. Many of the staff manning rural branches are posted there reluctantly and are unlikely to provide quality service to their clientele. Their lack of familiarity with agriculture and rural issues adds to problems in lending. The cadres of commercial bank officers do not have specialists in agriculture and other allied activities in rural areas (such as Agriculture Development Officers and Rural Development Officers) as was the case in the past. The Commission received a number of complaints from farmers about the negative attitude of bank staff.

Rain-fed and drought-prone areas suffer from low credit disbursal by commercial banks, since the costs of lending in these areas are seen to be high. The cost of lending differs across regions, depending upon factors such as the extent of irrigation, population density, differences in transportation cost and the time involved in contacting a similar number of people in a sparsely populated region. Therefore, there is a need for providing specific fiscal incentives to banks operating in less well-endowed regions.

Regional Rural Banks

Regional Rural Banks (RRBs) were set up in 1975 by an Act of Parliament to cater exclusively to the credit needs of rural population, especially small and marginal farmers. RRBs are owned by the central government (50 per cent), the state government concerned (15 per cent) and a sponsor commercial bank (35 per cent). The sponsor bank manages the RRBs. They are 16 RRBs with 1168 branches in the state of Andhra Pradesh.

An analysis of agency-wise credit flow in the state shows that the share of commercial banks has gone up and the share of Cooperatives has come down. But the share of RRBs is more or less stagnant at around 10 per cent of total credit disbursal.

There are many reasons for the marginal role of RRBs in total credit. Consequent upon the central governments' financial liberalisation measures in the early 1990s, the performance of the RRBs was evaluated on the basis of commercial profits instead of social benefits and RRBs were brought on par with other commercial banks in so far as the "weaker sections" and priority sector credit norms were concerned. The interest rates of the RRBs were freed, which led to a situation of the RRBs lending rates becoming the costliest among the formal players in the rural areas. In effect, credit from RRBs became costlier than from other agencies and the share of the "weaker sections" reduced drastically from 100 per cent to 10 per cent.

Cooperatives

The Andhra Pradesh Cooperative Bank (APCOB) is the apex body for credit co-operatives, with 24 branches. There are 22 District Cooperative Credit Banks at the district level with 583 braches and 4610 Primary Agriculture Cooperative Societies (PACs) at the village level covering 26,586 villages. Each PACS covers 5 to 6 villages. Properly functioning co-operatives are crucial for rural credit and should form the backbone of rural credit provision in the state. However, credit co-operatives in Andhra Pradesh, as elsewhere in the country, face problems such as political interference, lack of professionalism and lack of democratic functioning.

DCCBs have a number of problems. Deposits and recovery rates are low and have been declining. Due to poor recovery and high levels of NPA, recycling of funds is not possible. The viability of DCCBs has been a threat to the entire cooperative credit structure in the state. Only 8 DCCBs have been recognised as eligible for refinancing by NABARD. The recent credit disbursement performance of kharif 2004 indicates that co-operative banks have met only 60 per cent of the target for crops loans, which is even lower than what was achieved in the previous year. While they have provided more term loans, the rescheduling of crop loans to term loans has not taken place.

Various committees, including the Vyas Committee, the Capoor Committee, the Vikhe Patil Committee, the Rama Rao Committee, have looked into the functioning of co-operatives at the national level and in Andhra Pradesh. This Commission was not able to go into the issues with respect to credit co-operatives in any detail. However, the need to rejuvenate the cooperative structure is obvious and pressing, and the Commission therefore feels that the state government should undertake all possible measures for financial revitalisation and improved democratic functioning of the cooperatives. The synergies of commercial and cooperative strengths can be exploited, for example, if the DCCBs are to be ceded to one or other of the lead banks for some period until they are fully nursed back to health.

Recommendations

On access to bank credit

1. The basic aim of the formal banking system in the rural areas should be to ensure that all the credit requirements of farmers and other occupational groups are met, and that the coverage of the formal financial system is

extended to all rural households. For this, the emphasis on social banking rather than profit-based banking must be revived.

2. There must be a drive to ensure that all farmers (owner and tenants, including women farmers) receive kisan credit cards. The full scheme with respect to kisan credit cards must be implemented and there should be concurrent evaluation.

3. Before kisan credit cards are universally available to all cultivators, the transaction costs for borrowers should be reduced through establishing a single-window clearance. The need for a No Objection certificate from all banks in the vicinity should be done away with; instead, such banks within a particular service area should share among themselves the list of names of defaulters and borrowers well in advance of the crop season. The modalities of this process need to be worked out by the SLBC.

4. Prior to receiving pattas and kisan credit cards, tenant farmers and tribal farmers may access bank loans on the basis of certification of area cultivated by any one of the following: (a) Gram Panchayat (b) Self-Help Group (c) Village Organisation (d) Watershed Committee (e) Water Users' Association (f) Gram Sabhas in agency areas.

5. The composition of the State Level Banker's Committee (SLBC) should include farmers' representatives, NGOs and District Collectors from the three regions of the state. The District-Level Bankers' Committee (DCC) should similarly include representatives of farmers. The Collector at the District level should have a larger role by way of supervising the mechanisms relating to credit delivery including attitude of bank staff and the volume of credit that should reach the farmers. Block level Bankers' Committee (BLBC) should be revived and chaired by the Revenue Divisional Officer.

6. There is need for both state-level and national studies on the problems of rural credit in the era of financial liberalisation. We recommend that the state government

- commission a study on the state of rural indebtedness, and
- call for the RBI and NABARD to set up a High-Level Committee to review the working of the rural credit system.

7. At the national level, private banks should be brought under the discipline of social banking and adhere to the norms prescribed for nationalised banks.

8. The Agriculture Sub-Committee of the SLBC should ensure that the following are done regularly and within the required time:

- Assessing the credit needs, in terms of quantum and terms such as repayment schedules, for every year both crop-wise and season-wise, as well as checking the actual disbursal.
- Estimating the number of small and marginal farmers (men and women) to be included in the credit disbursal plan every year, and giving them priority.
- Estimating the credit needs of all the mandals with a special focus on drought-prone areas.

Similar activities should be undertaken by the District Consultative Committees and BLBCs.

9. The decline in credit disbursal must be reversed immediately. Therefore the following should be done at the very least:

- Banks should aim to return to a credit-deposit ratio of 80 per cent. Special attention should be paid to seven districts in which the CD ratio was below 50 per cent during 2004.

- The share of agriculture in total advances should be increased to a minimum of 25 per cent, which is the share of agriculture in the state's GDP.
- Indirect lending to agriculture should be in addition to this 25 per cent floor for agricultural lending. Specifically, lending for the following should be excluded from the category of agricultural lending: RIDF, agribusiness, agro-processing and urban-based activities.

10. With respect to the scale of finance:

- The RBI guideline with respect to loans without security must be strictly adhered to. Bank branches must be required to provide information about how many such applications have been received and how many loans have been given on that basis.
- Banks must observe the guidelines on scale of finance while sanctioning crop loans.

11. Other than crop loans (which must be at least 25 per cent of lending) there should be emphasis on lending for related activities such as dairy, livestock, fisheries and other on-farm enterprise.

12. Loans from institutional sources need to be available to farmers before the agricultural operations commence, so the government should direct all credit delivery institutions to begin the procedures well in time for the coming season.

13. Commercial banks must increase the number of rural branches, to reach one branch per 15,000 rural population, and provide adequate staff strength, including specialised officers such as Agricultural Officers.

14. The extension work of the bank should include both adequate and timely credit on the one hand and extension of agricultural technology on the other.

15. Banks need to inform potential and actual borrowers of all the various loan schemes available, the terms and conditions attached to loans, and particularly the terms of rescheduling etc. Such information should be displayed prominently in all bank branches in English and Telugu. Special attention should be taken to ensure that illiterate borrowers and potential borrowers are aware of the terms and conditions of loans.

16. The attitude of bank staff towards farmers needs to be re-oriented and monitored, with orientation to ensure that bank workers have a farmer-friendly attitude and avoid delays in sanctioning small loans.

17. Guidelines and application forms for loans need to be standardised and made easily available through websites, concerned government agencies, post offices, etc.

18. A strong grievance mechanism needs to be put in place at the Mandal level to ensure that the proposed guidelines are met by local bank branches. This could be assisted by the Gram Panchayats and under the overall supervision of the Mandal Revenue Officer.

19. Each branch manager must be held responsible for fulfilment of norms and punitive action must be taken against those who do not fulfil the norms, or according to complaints received by the grievance mechanism. Similarly, there should be incentives provided to bank staff who perform well in terms of providing adequate and timely credit to farmers. This must be done at the DCC level.

On interest rates and rescheduling

1. The state government should initiate a to set up a Distress Fund, with support from RBI and NABARD, that will provide support to banks in chronically drought prone areas, and permit some debt relief to cultivators. These funds may also be used to guarantee/underwrite loans taken by land reform beneficiaries (D form patta holders) and tenants.

2. All banks and co-operative societies lending to agriculture should provide a uniform rate of interest. This rate of interest should be 6 per cent annual rate at present, and even in future should not exceed the short-term deposit rate by more than 2 percentage points. Interest rates on bank loans must not be compounded every quarter.

3. Banks should not insist on 25 per cent margin money for crop loans.

4. There should be some incentives (in terms of reduced interest payment) for timely and prompt repayment.

5. Interest should not be charged for period of current rescheduling. Whenever an area is declared as drought-affected, interest should be waived, without changing other terms of rescheduling.

6. **The accumulated interest on a loan should not exceed the principal amount of the loan.** All the excess of accumulated interest over principal should be automatically written off by the banks. This will require appropriate amendment of the banking regulations, but is in conformity with the official government laws regarding private loans.

7. While banks have rescheduled crop loans according to the guidelines provided, in many cases new loans are not being given to those farmers whose loans have been rescheduled, even though this was also stipulated. Fresh loans must be provided to all such farmers.

8. Farmers who approach Helpline and are identified to be in genuine distress should be provided with access to loans up to Rs. 50,000.

9. Wide publicity should be given to the Andhra Pradesh (Andhra Area) Debtors' Protection Act, 1934 and it must be strictly implemented, especially with reference to interest rates and land alienation.

For regional rural banks

1. RRBs are rural financial institutions with professional management culture to meet small-value, large-volume rural credit needs. **There is a need to revamp the structure of RRBs so that they play a critical role in achieving the developmental targets in the rural sector and emerge stronger.**

2. RRBs should not be merged with their parent sponsoring organisations or commercial banks so that they may continue to meet the special needs of rural areas.

3. The RRBs in the state require capitalisation to revitalise their credit operations, so that all of them may reach CAR of 7 per cent.

4. As for commercial banks in rural areas, NPA norms of RRBs should be eased and allowance made for seasonal requirements.

5. The pre-1992 norms for CRR and SLR, under which RRBs were treated differently from other banks, should be re-imposed.

6. The ban on fresh recruitment should be lifted immediately and adequate staff must be ensured in the RRBs.

7. RRBs should not be shifted from rural locations, and those that have been shifted should be relocated to rural areas.

Special needs of drought-prone areas

There is a need to work out a separate branch model so that operating culture and business orientation in bank branches in these regions is explicitly designed to suit the local conditions. This requires changes in the policies of RBI and NABARD.

1. For banks in drought-prone areas, the following incentives may be considered:
   - The performance criteria for banks should be different and more flexible in drought-prone areas
   - The interest tax should be lowered for banks providing agricultural credit in drought prone districts due to the risky nature of investment due to persistent drought.

2. Flexible and longer repayment schedules are necessary for crop loans in drought-prone areas.

3. New and innovative instalment repayment collection systems need to be tried out.

Crop insurance

Since agriculture has become an even more risky enterprise, crop insurance is essential. But only a very small proportion of cultivators are today covered by the National Agricultural Insurance Scheme (NAIS).

1. The coverage of this scheme must be expanded to make it accessible to all farmers, not only borrowers of institutional finance, and to cover all crops, including horticultural crops.

2**.** The 50 per cent subsidy (provided by state and central governments) on the premium on crop insurance for small and marginal farmers should be maintained.

3. The premium rates paid by the cultivator should not exceed 3 per cent for any crop. Where the rate is higher, the balance should be met through a subsidy provided to the insurance company by the government.

4. Crop insurance should not be compulsory for any farmer, including those taking crop loans from banks.

5. The amount insured may be flexible, in that farmers may choose to insure any amount up to a specified limit per crop per season.

6. Insurance companies must be allowed to increase staff substantially so as to be able to cater to the requirements of rural customers.

7. The current principles for calculating compensation should be revised. The Department of Agriculture has already proposed the following:

- the threshold yield should be based on normal yield instead of the preceding three or five years.
- the minimum indemnity should be 80 per cent instead of 60 per cent.
- the level for calculation of insurance compensation should be the village.
- the settlement of claims should be quick, within 60 days of the claim.