UNIT .III . Agricultural Finance.

Concepts of agriculture finance;

Agriculture is the art and science of cultivating the soil, growing crops and raising livestock. It includes the preparation of plant and animal products for people to use and their distribution to markets. Agriculture provides most of the world's food and fabrics.

Need for Agricultural Finance

The need of finance for agriculture can hardly be over emphasized where its productivity is still low due to financial constraints. In this context, All India Rural Credit Survey has observed: “Agricultural credit is a problem when it cannot be obtained; it is also a problem when it can be had but in such a form that on the whole it does more harm than good. It may be said that, in India, it is thus twofold problem of inadequacy and unsuitability that is perennially presented by agricultural credit”. Undoubtedly, an Indian farmer is not able to make the maximum use of his time, labour and productive capacity of his land because of the lack of adequate financial facilities. According to Husband and Dockeray, “Finance is necessary for any economic activity…. Something must direct the flow of economic activity and facilitate its smooth operation. Finance is the agent that produces this result.”s However, the need for various types of agricultural finance can be discussed under the following heads:

1. Productive and Unproductive Credit Needs:

 An agriculturist require credit for the purpose of production and consumption. In other words, credit needs of the farmers can be classified into two parts—(i) Credit needed for productive purposes; and (ii) Credit needed for unproductive purposes. The loans which are used in productive operation of agriculture are called the productive credit. However, productive requirements of the farmers and loans for purchase of cattle, implements, fertilizers, inputs, better seeds and machinery etc. On the contrary, farmers need credit for consumption purposes. The loans which are used for consumption purposes are called the unproductive credit. Between the moment of marketing of agricultural produce and harvesting of next crop, there is a long interval of time. Most of the farmers do not have sufficient income to sustain them through this period. Therefore, they have take loans for meeting their consumption needs. In the times of drought or flood, when the crops are damaged, the farmers have also to insure such loans. In fact, unproductive loans are also taken for social purposes like birth of a male child, marriage or death of person in the family. Litigation too forces the farmers to borrow. As a result, they pay heavy rate of interest. The repayment of loan and interest become almost impossible and the burden of debt accumulates. According to an estimate, more than half of the borrowed funds were utilized for unproductive family expenditure and only one third was spent on the farm improvement.

 2. Credit Needs According to Purpose:

According to Reserve Bank of India, credit needs can be classified by its purposes:

1. For Meeting Family Expenditure: This type of credit is needed for purchase of domestic utensils and clothings, paying for medical, educational and other family expenses etc.
2. (ii) For Non-Farm Business Purpose: Such credit is required for the repair of production ad transport equipment, furniture, construction and repair of building or non-farm houses and other capital expenditure and non farms business.
3. (iii) For Agricultural Purposes: The farmers need credit for the purpose of seed, manure and fodder, payment of rent, wages, irrigation of crops, hire charges of pumps, purchase of livestocks, repair of agricultural implements, land improvement, for laying of orchard and capital expenditure on agriculture.
4. (iv) Other Purposes: Such expenditure includes repayment of old debts, deposits with cooperative agencies, shares and unspecified purposes etc.

 3. Credit Needs According to the Length of the Loan Period:

 These credits of the farmers can be classified into three parts, short term credit, medium term credit and long term credit as under:

 (i) Short Term Credit:

These loans are needed for the purchases of seeds, fertilizers, pesticides, feed and fodder of livestock etc. The period of such loans is upto 15 months. The farmers also need these loans to support their family in those years when the crops have not been good enough. Main agencies for the grant of these loans are the money lenders and the co-operative societies. These loans may be both for productive as well as for unproductive purposes.

 (ii) Medium Term Credit:

Farmers generally obtain these loans for the purchase of cattle, small agricultural implements, repair and construction of wells, farm building and fencing etc. The period of these loans ranges between 15 months to 5 years. These loans are provided by money lenders, relatives of farmers and commercial banks etc.

 (iii) Long Term Credit:

 It includes the loans for making improvement on land, purchase of expensive machinery, purchase of additional land, digging of wells and repayment of old debts etc. The amount involved in such loans is very large. The rate of interest on such loans is generally low. These loans are advanced for a long period ranging between 5 to 20 years.

 Sources of Agricultural Finance

 There are two broad sources of agricultural credit in India:

 A. NON-INSTITUTIONAL SOURCES:

The non-institutional finance forms an important source of rural credit in India, constituting around 40 percent of total credit in India. The interest charged by the non-institutional lenders is usually very high. The land or other assets are kept as collateral. The important sources of non-institutional credit are as follows: • Money-Lenders: Money-lending has been the widely prevalent profession in the rural areas. The moneylenders charge huge rate of interest and mortgage the property of the cultivators and in some cases even the peasants and members of his family are kept as collateral.

 • Other Private Sources: (a)

Traders, landlords and commission agents: The agents give credit on the hypothecation of crops which when harvested is used to repay loans.

 (b) Credit from relatives:

These credits are generally used for meeting personal expenditure.

 B. INSTITUTIONAL SOURCES:

 The general policy on agricultural credit has been one of progressive institutionalization aimed at providing timely and adequate credit to farmers for increasing agricultural production and productivity. Providing better access to institutional credit for the small and marginal farmers and other weaker sections to enable them to adopt modern technology and improved agricultural practices has been a major thrust of the policy. National Notes www.iasscore.in Indian Economy 5 Bank for Agriculture and Rural Development (NABARD) is an apex institution established in 1982 for rural credit in India. It doesn’t directly finance farmers and other rural people. It grants assistance to them through the institutions described as follows:

 • Rural Co-Operative Credit Institutions:

 Rural Credit cooperatives are the oldest and most extensive form of rural institutional financing in India. The major thrust of these cooperatives in the area of agricultural credit is the prevention of exploitation of the peasants by moneylenders. The rural credit cooperatives may be further divided into short-term credit cooperatives and long-term credit cooperatives. The short-term credit cooperatives provide short-term rural credit and are based on a three-tier structure as follows:

(a) Primary Agricultural Credit Societies (PACs):

These are organized at the village level. These societies generally advance loans only for productive purposes. The main objective of a PACS is to raise capital for the purpose of giving loans and supporting the essential activities of the members such as supply of agricultural inputs at cheap price, improving irrigation on land owned by members, encourage various income-augmenting activities such as horticulture, animal husbandry, poultry etc. In India, around 99.5 percent of villages are covered by PACs.

 (b) District Central Cooperative Banks:

 These cooperatives are organized at the district level. The PACS are affiliated to the District Central Co-operative Banks (DCCBs). DCCBs coordinate the activities of district central financing agencies, organize credit for PACs and carry out banking business.

 (c) State Co-Operative Banks:

The DCCBs are affiliated to State Co-operative Banks (SCBs), which coordinate the activities of DCCBs, organize provision of finance for credit worthy farmers, carry out banking business and act as leader of the Co-operatives in the States. Long-term credit Cooperatives: These cooperatives meet long-term credit of the farmers and are organized at two levels:

1. Primary Co-Operative Agriculture and Rural Development Banks: These banks operate at the village level as an independent unit.
2. (ii) State Co-Operative Agriculture and Rural Development Banks: These banks operate at state level through their branches in different villages.

• Commercial Banks: Commercial Banks (CBs) provide rural credit by establishing their branches in the rural areas. The share of commercial banks in rural credit was very meager till 1969. The All India Rural Credit Review Committee (1969) recommended multi agency approach to the rural and especially agricultural credit. It suggested the increasing role of the CBs in providing agricultural credit. Further, under the Social Control Policy introduced in 1967 and subsequently the nationalization of 14 major CBs in 1969 (followed by another six banks in 1980), CBs have been given a special responsibility to set up their advances for agricultural and allied activities in the country. The major expansion of rural branches took place and CBs introduced Lead Bank scheme and district credit plans for rural areas. Banks were asked to lend 18 percent of their total advances to agriculture within the quota of 40 percent of priority sector lending. This expansion of rural credit remained till the late 1980s. However, during late 80’s, CBs suffered huge losses due to waiving of agricultural loans by the government. The financial liberalization process with the adoption of Narasimham Committee report in 1993 has necessitated Notes 6 Indian Economy INDIAN AGRICULTURE 2016 EDITION the banks to focus on profitability and adopt prudential norms. The proportion of bank credit to rural areas especially small borrowers has come down steadily.

• Regional Rural Banks (RRBS):

 RRBs are the specialized banks established under RRB Act, 1976 to cater to the needs of the rural poor. RRBs are set-up as rural-oriented commercial banks with the low cost profile of cooperatives but with the professional discipline and modern outlook of commercial banks. Between 1975 and 1987, 196 RRBs were established with over 14,000 branches. As a result of the amalgamation, the number of RRBs was reduced from 196 to 133 as on 31 March, 2006 and to 96 as on 30 April 2007. RRBs covered 525 out of 605 districts as on 31 March 2006. After amalgamation, RRBs have become quite large covering most parts of the State. Increased coverage of districts by RRBs makes them an important segment of the Rural Financial Institutions (RFI). The branch network of RRBs in the rural area form around 43 per cent of the total rural branches of commercial banks. A large number of branches of RRBs were opened in the un-banked or under-banked areas providing services to the interior and far-flung areas of the country. RRBs primarily cover small and marginal farmers, landless laborers, rural artisans, small traders and other weaker sections of the rural community. However, even after so many years, the market share of RRBs in rural credit remained low and have suffered huge losses. In recent years Government has initiated reform process to improve the functioning of RRBs.

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1. Meaning of Agricultural Credit:

Agricultural credit is considered as one of the most basic inputs for conducting all agricultural development programmes. In India there is an immense need for proper agricultural credit as Indian farmers are very poor. From the very beginning the prime source of agricultural credit in India was moneylenders.

After independence the Government adopted the institutional credit approach through various agencies like co-operatives, commercial banks, regional rural banks etc. to provide adequate credit to farmers, at a cheaper rate of interest. Moreover, with growing modernisation of agriculture during post-green revolution period the requirement of agricultural credit has increased further in recent years.

2. Types of Agricultural Credit:

Considering the period and purpose of the credit requirement of the farmers of the country, agricultural credit in India can be classified into three major types:

(a) Short Term Credit:

The Indian farmers require credit to meet their short term needs viz., purchasing seeds, fertilisers, paying wages to hired workers etc. for a period of less than 15 months. Such loans are generally repaid after harvest.

(b) Medium Term Credit:

This type of credit includes credit requirement of farmers for medium period ranging between 15 months and 5 years and it is required for purchasing cattle, pumping sets, other agricultural implements etc. Medium term credits are normally larger in size than short term credit.

(c) Long Term Credit:

Farmers also require finance for a long period of more than 5 years just for the purpose of buying additional land or for making any permanent improvement on land like sinking of wells, reclamation of land, horticulture etc. Thus, the long term credit requires sufficient time for the repayment of such loan.

3. Sources of Agricultural Credit in India:

In India, agricultural credit are being advanced by different sources. The short term and medium term loan requirements of Indian farmers are mostly met by moneylenders, co-operative credit societies and Government. But the long-term loan requirements of the Indian farmers are also met by moneylenders, land development banks and the Government.

Nowadays, the long term and short term credit needs of these institutions are also being met by National Bank for Agricultural and Rural Development (NABARD).

Sources of agricultural credit can be broadly classified into institutional and non-institutional sources. Non-Institutional sources include moneylenders, traders and commission agents, relatives and landlords, but institutional sources include co-operatives, commercial banks including the SBI Group, RBI and NABARD.

Table 7.15 shows the contribution of these different sources to the total agricultural credit in India since 1951- 52 to 1996.



Borrowing of Cultivators

It can be revealed from Table 7.15 that among all the different non-institutional sources the contribution of money lenders was highest and that was to the extent of 69.7 per cent. But its contribution gradually came down to 49.2 per cent in 1961-62 and then to 7.0 per cent in 1996. Total contribution of non-institutional source towards agricultural credit has gradually declined from 92.7 per cent in 1951-52 to 25.0 per cent in 1996.

The share of institutional sources to the total agricultural credit which was 7.3 per cent in 1951-52 gradually increased to 18.7 per cent in 1961-62 and then to 75.0 per cent in 1996. Out of these institutional sources, co-operatives contributed 40 per cent and commercial banks contributed 30.0 per cent of the total farm credit in 1996.

I. Non-Institutional Sources:

(i) Moneylenders:

From the very beginning moneylenders have been advancing a major share of farm credit.

Moneylenders are of two different types:

(a) Professional moneylenders

(b) Agriculturist moneylenders.

These moneylenders were supplying a major portion of agricultural credit (69.7 per cent in 1951-52) and indulged into malpractice like manipulation of accounts and charged exorbitant rate of interest on their loan- often 24 per cent and over.

Due to all these factors the share of moneylenders in total farm credit has declined sharply from 69.7 per cent in 1951-52 to 36.1 per cent in 1971 and then to only 16.1 per cent in 1981 and then to 7.0 per cent in 1995-96.

(ii) Traders and Commission agents:

Traders and commission agents are also advancing loan to the agriculturist for productive purposes before the maturity of crops and then force the farmers to sell their crops at very low prices and charge heavy commission. This type of loans is mostly advanced for cash crops.

The share of these traders in farm credit increased gradually from 5.5 per cent in 1951-52 to 8.8 per cent in 1961- 62 and then sharply declined to 5.0 per cent in 1996. Thus its importance has been declining in recent years.

(iii) Relatives:

Cultivators are also normally borrowing fund from their own relatives in times of their crisis both in terms of cash or kind. These loans are a kind of informal loans and carry no interest and are normally returned after harvest.The importance of this source of farm credit is also declining as its share of agricultural credit has already declined from 14.2 per cent in 1951-52 to 8.7 per cent in 1981 and then to 3.0 per cent in 1995-96.

(iv) Landlords:

In India, small as well as marginal farmers and tenants are also taking loan from the landlords for meeting their financial requirements. This source has been following all the ill-practices followed by money-lenders, traders etc.

Sometimes landless workers are even forced to work as a bonded labour. The share of this source to rural credit has increased from 3.3 per cent in 1951-52 to 14.5 per cent in 1961-62 and then sharply declined to 8.8 per cent in 1981 and then to 10.0 per cent in 1995-96.

Thus, the non-institutional sources of farm credit have been facing serious loopholes like exorbitant rate of interest, loan for unproductive purposes, non-repayment of loan etc.

II. Institutional Sources:

The main motive of institutional credit is to assist the farmers in raising their agricultural productivity and maximising their income. Institutional credit is also not exploitative in character. The following are some of the important institutional sources of agricultural credit in India.

(i) Co-operative Credit Societies:

The cheapest and the best source of rural credit in India is definitely the co-operative finance. In India the active primary agricultural credit societies (PACS) cover nearly 86 per cent of the Indian villages and account for nearly 36 per cent of the total rural population of the country. The share of co-operatives in the total agricultural credit increased to nearly 40 per cent in 1996 as compared with only 3 per cent in 1951-52.

In 1993-94 nearly 88,000 primary agricultural credit societies (PACS) of India provided Rs 6461 crore as short term and medium term loans to the farmers. In 2006-2007, the same loan has increased to Rs 42,480 crore, which was financed by co-operative banks.

But these co-operatives have a long way to go. In some states like Bihar, West Bengal, Orissa and Rajasthan the co-operative movement did not spread much of its net world. Even in some places the working of the co-operatives had been wrecked hopelessly by unscrupulous and dishonest members leading to large scale sufferings of huge number of needy farmers.

(ii) Land Development Banks:

Land development banks are advancing long term co-operative credit for 15-20 years to the farmers against the mortgage of their lands for its permanent improvement, purchasing agricultural implements and for repaying old debts. The number of state land development banks (SLDBs) increased from 5 in 1950-51 to 19 as on June 1986 which again consisted of 2447 Primary Land Development Banks (PLDBs) branches.

The amount of loan sanctioned annually by these PLDB branches has increased from Rs 3 crore in 1950-51 to Rs. 2039 crore in 1993-94. But benefits from these land development banks could not reach to small farmers and only the big landlords have been taking all advantages out of it. At present there are 19 central and 733 primary LDBs. In 1997, these banks advanced loan worth Rs 1,744 crore.

(iii) Commercial Banks:

In the initial period, the commercial banks of our country have played a marginal role in advancing rural credit. In 1950-51, only 1 per cent of the agricultural credit was advanced by the commercial banks. But after the nationalisation of commercial banks in 1969, the commercial banks started to extend financial support both directly and indirectly and also for both short and medium periods.

With the help of “village adoption scheme” and service area approach the commercial banks started to meet the credit and other requirements of the farmers. They also sponsored various regional rural banks for extending credit to small and marginal farmers and rural artisans just to save them from the clutches of village moneylenders.

Till 1969, direct advances by the commercial banks were restricted to only Rs 44 crore. But as on March 2007 the amount of loan has increased to Rs 1,40,382 crore. During 2006-2007 commercial banks along with Regional Rural Banks extended nearly 79.1 per cent of the total institutional farm credit in our country.

Again in 1999-2000, disbursements of agricultural advances by public sector banks under Special Agricultural Credit Plan (SACP) were Rs 19,755 crore.

Commercial banks are finding difficulty in advancing loans to the farmers particularly in respect of lending techniques, security, recovery etc. and are expected to overcome these gradually. But the commercial banks are not very much interested to advance loan to small and marginal farmers and as on March 1997 their farm credit was restricted to only 13.5 per cent of total bank credit.

The share of commercial banks in total institutional credit to agriculture is almost 69.0 per cent in 2006-2007.

(iv) Regional Rural Banks:

As per the recommendations of working Group on Rural Banks the Regional Rural Banks (RRBs) were established in 1975 for supplementing the commercial banks and co-operatives in supplying rural credit. Since 1975 these Regional Rural Banks are advancing direct loans to small and marginal farmers, agricultural labourers and rural artisans etc. for productive purposes.

Till June 1996, in total 196 RRBs have been lending annually nearly Rs 1500 crore to the rural people and more than 90 per cent of these loans were also advanced to the weaker section.

At the end of 1988 these RRBs jointly advanced loan to the extent of Rs, 2,804 crore among 11 million persons lying below the poverty line. In 2006-2007, the RRBs have disbursed agricultural credit amounting to Rs 20,435 crore which is just 10.05 per cent of total institutional credit to agricul

NABARD

Development of food processing industry in the country is accorded top priority by the Government of India as it is one of the most critical links in the agri value chain. Taking this agenda further, the Hon’ble Finance Ministry, in 2014, announced setting up of a Special Fund of Rs.2,000 crore in NABARD for providing direct term loans at affordable rates of interest to Designated Food Parks (DFPs) and food processing units in the DFPs.

The objectives of the Fund are:

* To provide impetus to development of the food processing sector on a cluster basis  in the country
* To reduce wastage of agricultural produce
* To create employment opportunities especially in rural areas.

**Scope of Financing from the Fund**

The Fund provides Term loans for:

* Development/establishment of all infrastructure required in the DFPs
* Augmentation/modernization/creation of additional infrastructure in the DFPs
* Setting up of individual food processing units or any other unit that is established for supporting the operations of the food processing units within the DFPs; and
* Modernization of existing processing units in the DFPs resulting in process technology upgradation, automation, increased efficiency, improvement in product quality, reduction in costs, etc.

**Eligible Borrowers**

The following entities are eligible from the Fund for term loan assistance from NABARD:

• State Governments

• Entities promoted by State Governments or Government of India

• Joint Ventures

• Special Purpose Vehicles (SPVs)

• Cooperatives

• Federations of Cooperatives

• Farmers’ Producer Organizations

• Corporates

• Companies

• Entrepreneurs etc

 (v) Government:

Another important source of agricultural credit is the Government of our country. These loans are known as taccavi loans and are lend by the Government during emergency or distress like famine, flood etc. The rate of interest charged against such loan is as low as 6 per cent.

The share of the Government in the total agricultural credit has increased from 3.1 per cent in 1951-52 to 15.5 per cent in 1961-62 but then the share declined to only 5.0 per cent in 1996. During 1990-91, the state Governments had advanced nearly Rs 350 crore as short-term loan to agriculture. But the taccavi loan failed to become very much popular due to official red tapism and corruption.

Agricultural insurance;

Agricultural insurance protects against loss of or damage to crops or livestock. It has great potential to provide value to low-income farmers and their communities, both by protecting farmers when shocks occur and by encouraging greater investment in crops. However, in practice its effectiveness has often been constrained by the difficulty of designing good products and by demand constraints.

Agriculturalinsurance can indemnify policyholders for losses, though such indemnity products are relatively rare due to the high costs of administration and the risk of fraud. More commonly, agricultural microinsurance is index-based, providing farmers with payouts tied to the performance of an index (such as a rainfall gauge), rather than indemnifying them for crop losses actually experienced. While they avoid the need for costly (and often impossible) verification of damage, index products have a shortcoming in the form of [basis risk](http://www.microinsurancenetwork.org/glossary), the difference between the performance of the index and the damage the policyholder actually suffered. In some cases, this basis risk can be quite large, but can be reduced through improvements in the index.

* Designing appropriate products with limited or inaccurate data about the risk and about clients’ alternatives without insurance.
* Designing sustainable products (from the insurer’s perspective), given the risks of fraud, adverse selection, and moral hazard.
* Minimising distribution costs, which often involves tapping into an existing distribution infrastructure.
* Explaining how these relatively complex products work to overcome understanding and trust barriers among target clients and to ensure that those who buy the product have a clear understanding of what is covered.
* Overcoming liquidity constraints to purchasing insurance from farmers, who earn income seasonally (this can be done through careful timing of enrolment or through creative payment arrangements).
* Retention of clients, who may not receive a payout for years and lack tangible evidence that the product will work as promised.