

# AGRICULTURE FINANCE

## Introduction

Finance has been recognized as the life blood of all economic activities. Like all other producers, agriculturist also needs credit. According to an old proverb “Credit supports the farmers as the hangman’s rope supports the hanged.” This statement is fully true in the context of Indian farmers. Thus, for stimulating the tempo of agricultural production, an adequate and timely credit, is most essential.

Generally, in underdeveloped countries farmers cannot expect their credit needs to come from savings. It is so because their income from farm operations is sufficient to provide minimum necessities of life. Therefore, they have to rely upon outside finance. In olden days, rural debt was considered as an unmixed evil, but now time has changed altogether. Modern agriculture is a costly affair. Credit is needed to adopt new farm technology resulting in ushering of green revolution. In India, it has two fold necessity. Firstly crop productivity is very low due to traditional methods of cultivation and secondly, there is an urgent need to enhance agricultural production to get self sufficiency and to save valuable foreign exchange. In short, effective arrangements are needed to provide credit facilities so that agriculturist may adopt better techniques of production.

The different studies conducted show a strong positive relationship between agricultural growth and availability of credit. Broadly, credit in agricultural sector may be divided into short-term loans to meet the input expenses and medium and long-term loans to facilitate the development of fixed farm assets such as land. This gap arises in relation to static or dynamic production function. Under a static functioning, the level of input use per hectare of cropped area being constant, the year to year variation in the amount of credit reflects the changes in input prices. Under a situation of diminishing returns, however, increasing input use is required to maintain the same level of output. The supply of credit related to static production conditions will not contribute to increase in output, although the withdrawal of it might lead to a decline in conditions will not contribute to increase in output, although the withdrawal of it might lead to a decline in output. Under dynamic functions, credit requirements would rise from year to year even if input prices remain constant. The growth in credit under such dynamic conditions would lead to increased output. In the same way the investment credit too would lead to an improvement in the production potential of the farms through the process of net capital formation.

The agrarian history from Rome to Scotland is that agricultural credit is an essential. Neither the condition of the country nor the nature of land tenures nor the position of agriculture affect one great fact that farmers must borrow. Agricultural credit, thus, in a practical sense, is a nucleus of the system of farm operation. It provides flow to the system averting ruins which would have occurred due to the lack of monetary capacity of farmers. Thus adequate and timely credit to the farmer is, vital and indispensable for the rehabilitation and progress of agriculturists. In underdeveloped countries, agriculture assumes even more importance. Farmer’s inability or least limited ability to save does not allow him to finance his pursuits and raise better production from his farms. Agricultural credit through institutional channels is the only way to break agricultural stagnation. Private funding agencies play a limited role keeping in view the larger public interest.

## Features of Agricultural Finance

In our country, agricultural finance has the special features which are discussed below in detail:

1. **Risks in Agriculture:** In agriculture sector, it is difficult to foresee risks and uncertainties. A farmer has to face numberless risks and uncertainties as droughts, floods etc. It may cause considerable damage to

the farmer. Moreover, agricultural produce tends to deteriorate in storage due to lack of proper storage facilities to hold back surplus when supply exceeds demand. It leads to further difficulties. Thus, with so much uncertainties, agriculture has always been a risky affair to be handled by the commercial banks and insurance companies.

2. **Difficulties of Co-operation in Agriculture:** In agricultural sector, there is a very little scope of co-operation. It is so because, farmers are mostly individualistic and are suspicious of co-operating with each other for a common purpose. This creates difficulties to the farmers in getting cheap credit.
3. **Economic Lags in Agriculture:** In agricultural production process, there is a long interval between the reward and effort specially during the period when costs are incurred. During this period, demand for agricultural produce may change upsetting the financial adjustments of the farmers. In this way, farmers have to bear another uncertainty. This becomes an excuse for credit supplying agencies to refuse credit for farm operations.
4. **Credit for Consumption Purpose:** Indian farmers require credit not only for production purposes but also for consumption purposes. In the case of crop failure, small farmers need credit which they spend on consumption requirements. Moreover, Indian farmers are accustomed to spend beyond their means on social and religious functions. In addition to all this, litigation is another important non-productive requirement for funds.
5. **Small Size of Farm:** In India, size of farms is very small in comparison to the amount of labour employed and the extent of the capital invested. Moreover, there is no control over the yield and the quality of the produce. Thus, there is a lack of security to be offered for loans.
6. **Lack of Proper Securities:** The large farmers have their own resources which enable them to raise funds from the credit institutions. Small farmers find it extremely difficult to raise credit for their needs. It is due to the reason that small farmers neither possess proper securities to pledge against loans, nor they have adequate repaying capacity. As a result, small farmers are forced to go to the money lenders.
7. **Complex of Many Industries:** Agriculture is an industrial complex of varying types of production and marketing. The size of holdings and forms of land tenure differ from one area to another. These differences create different types of complex relations between the farmers which makes financing of agricultural sector relatively difficult.

### Criteria for Agricultural Credit

In any scheme of agricultural finance, there must be some criterion on the basis of which the superstructure of various agencies has to be built up. Since the farmer's needs for finance and the methods of operation differ widely from non-agricultural financing, it is more necessary to keep certain criteria in mind. According to Mr. Louis Tardy, the various criteria of a suitable type of credit may be set down as follows:

- (1) To be granted for a sufficiently long period, commensurate with the length of the operation;
- (2) To be granted at a low rate of interest;
- (3) To be adequately secured, in order, more particularly, to avoid any abuse of credit facilities, but the security should not necessarily be material; it should be in the form of a personal credit secured mainly by the borrower's moral standing and farming ability;
- (4) be adapted to the average yield and capacity for repayment of the farms, particularly during periods of economic depression;

- (5) To be placed in the hands of institutions, the directors of which have received special training; and have actual banking experience.

The following criteria may also be added.

- (i) There should be possibility of extension of the term of credit in the event of crop failure;
- (ii) It should be made locally available without delay; and
- (iii) The agency engaged for the purpose should be able to find out facts about the borrowers readily.

## 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:
  - (i) 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.
  - (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.

- (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 livestock, repair of agricultural implements, land improvement, for laying of orchard and capital expenditure on agriculture.
- (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 money-lenders 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

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:

- (i) Primary Co-Operative Agriculture and Rural Development Banks:** These banks operate at the village level as an independent unit.
- (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



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.

### Measures taken to improve credit flow to agriculture

Credit is an important mediating input for agriculture to improve productivity. Access to institutional credit enables the farmer to enhance productivity by investing in machinery and purchase of variable inputs like fertilizers, quality seeds, and manure and providing funds till the farmer receives payment from sale of produce, which is at times delayed and staggered.

Input use by farmers is sensitive to credit flows to the agriculture sector. In this context, the predominance of informal sources of credit for farmers is a concern. According to NSSO, 70th round data, as much as 40 per cent of the funds of farmers still come from informal sources. Local money lenders account for almost 26 per cent share of total agricultural credit.

Though there has been a decline in informal sources over time, enhancing access to institutional credit for farmers needs to be addressed. There is need to address the problem of availability of credit on several fronts. In respect of high interest rates, DBT may be considered to replace subvention of interest rates.

The intermediation and refinance model to promote agricultural credit needs to be revisited and replaced with DBT that shall subsidize the interest paid by the farmer, instead of subsidizing refinance to financial institutions.

The following measures have been taken for improving agricultural credit flow and bringing down the rate of interest on farm loans:

- (i) Agricultural credit flow target for 2013-14 was fixed at Rs. 7,00,000 crore and achievement was Rs. 7,30,765 crore (Provisional), as against Rs. 6,07,375 crore in 2012-13. Agricultural credit flow target for 2014-15 has been fixed at Rs. 8,00,000 crore against which achievement has been Rs. 3,70,828.60 crore (Provisional) up to 30 September, 2014.
- (ii) Farmers have been availing of crop loans up to a principal amount of Rs. 3,00,000 at 7 per cent rate of interest. The effective rate of interest for farmers who promptly repay their loans is 4 per cent per annum during 2014-15.
- (iii) In order to discourage distress sale of crops by farmers, the benefit of interest subvention has been made available to small and marginal farmers having Kisan Credit Cards for a further period of up to six months