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What Constrains Agriculture Credit in India? How to Improve the Outreach? An Essay on Current Approach and Practices

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ABSTRACT

There has been substantial growth in agriculture credit, in India over the years. Yet rural banking continues to, substantially lag behind urban/metro centres in terms of average population per branch, ATM and POS machines. Agriculture credit delivery in the country is impacted by issues such as poorly staffed rural branches, inadequate loan amounts due to standardisation and lengthy procedures. Viability of agriculture and agriculture credit is challenged by inefficiencies in crop insurance, lack of smooth market access to the farmer to sell his produce, lack of price risk management instruments etc. The large number of regulatory/supervisory guidelines on rural credit, instead of augmenting credit have possibly resulted possible denial of credit due to a compliance oriented mindset with bankers. Banks need more freedom to take credit decisions. Allowing collateral could increase credit volumes. There is a strong case to have differential NPA norms for agriculture and rural credit which are vulnerable to vagaries of weather and rural borrowers lack funds to manage cash flow volatility. Farmers and banks must hedge price risk in commodity market for which financial instruments should be introduced. There is a strong case to make KCC a full cash credit by removing narrowly stipulated repayment clauses. Productisation of agriculture credit coupled with procedural and conceptual changes could be considered which will hasten credit flow to small and marginal farmers.

Keywords: Agricultural credit, Crop loan, Price risk management.

JEL: O13, Q10, Q14, Q15, Q17

I

As per World Bank report and TRAI data there are 104.97 crore mobile phones in India with a population of 129.52[1] crore. 82.17 mobile connections for every 100 population. TRAI also says that number of mobiles in use India as on June 2016 reached 103.5 crore. The story of internet is similar. It is reported that 46.21 crore persons, i.e., nearly 35 per cent of the population in India use internet.[2] Many of these mobiles and internets are used for banking. Customers also made use of more than 2 lakh ATMs and 1.5 million POS[3] in the country. It is noteworthy that people found value in all these banking channels and used/accepted them without any demand for subsidy or subvention. On the contrary, banks have already started charging usage charges on all these and hope to make sizable income! It should be said that the growth of these in urban areas is more than rural. Yet it must be said that people, even villagers found value in these and there was no need for RBI, or Governments, or banks to take special efforts to make people accept/use ATM, POS, mobile banking or internet.

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This paper is on agriculture. Then why talk of mobiles and internets? The answer is simple. The growth trajectory of use of debit cards, mobile banking and other technology driven delivery channels of banking over the last few years when compared with the growth of agricultural credit and rural banking outreach over the last few decades are far more impressive. Is it a design issue? Is it procedural issue? Is bank credit difficult to access? Why farmers are not flocking to banks to get KCC? Why KCC has not been issued to all the farmers in the country?[4] Today, most of agricultural credit is extended at 7 per cent. It is the cheapest among all loans extended by banks. In some states, the rate of interest is less than 4 per cent. Agricultural credit is mandated priority with banks. This should make farmers rush to the bank. But it is not the case. According to the All India Debt and Investment Survey, NSSO 59th Round had reported that nearly 51per cent of farmers are not in formal credit fold. More importantly most of the small and marginal farmers are not credit included. Agricultural credit is not growing as fast as one would want it to grow. Evidently there are issues in agricultural credit which impedes growth.

Banks have been, however continuously nudged by Government and RBI to lend more to agriculture. Agricultural credit is a thrust area under priority sector credit. Also, Government extends interest subsidy to banks so that farmers will get the loans at 7 per cent rate mentioned above. Despite all these measures, as evidenced by NSSO and other studies, outreach of agricultural credit has not been impressive. Generally, agricultural credit is seen in terms per cent of net bank credit which banks have extended during a year. The targeted is 18 per cent of net bank credit. The achievement currently hovers around 16 per cent. Another way of evaluating agriculture and rural credit could be comparing exposure of banks to agriculture and rural credit in terms of total assets of the bank. It would show that the rural credit extended by the banks to nearly 2/3rd of the population works out to a poor 8 per cent of the total assets of bank. Either way agricultural credit is, definitely inadequate. It is in this background, we take up an analysis of current status and issues in agriculture and rural credit, its processes, procedures and challenges.

II

STATUS OF AGRICULTURE CREDIT AND OUTREACH

2.1 Over the years, credit flow to agriculture has, definitely increased. Total disbursement for crop loan was Rs 8,77,724 crores in 2015-16.[5] This is indeed a remarkable achievement for only a decade back, in the year 2004 doubling of credit was announced by the FM with a target of Rs.1 lakh crore for the next year! Since then growth in credit flow has been impressive. So much so that in 2017 FM has announced a target of Rs One million crore! The current emphasis in on “doubling of farm income”.

2.2 Commercial banks account for the largest share in lending to agriculture, particularly crop loan. Between 2004 and 2015 (Figure 1) commercial banks increased their credit flow to agriculture by 7 times. Co-operative banks have increased the credit flow by 4 times and Regional Rural Banks (RRB) 8 times (Figure 2). The share of RRB's in overall crop loans disbursed by banks has, over last two decades, remained stagnant around 10-11 per cent.

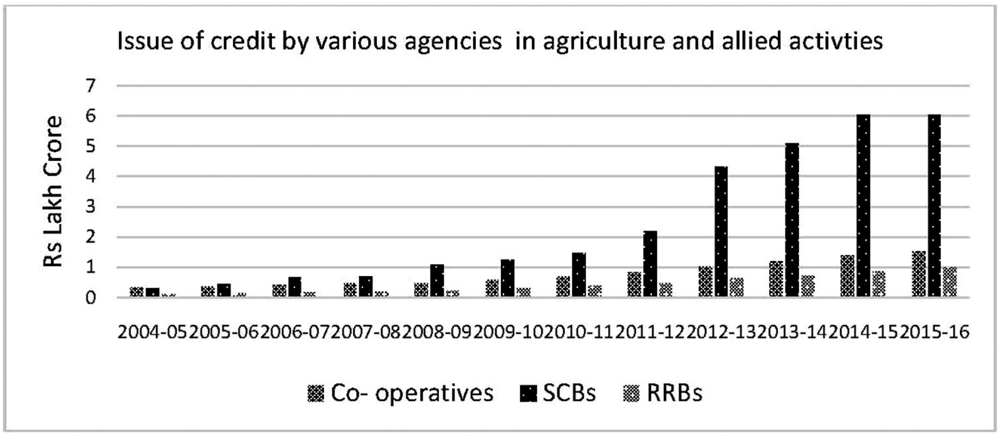

Figure 1. Flow of Credit to Agriculture and Allied Activities.

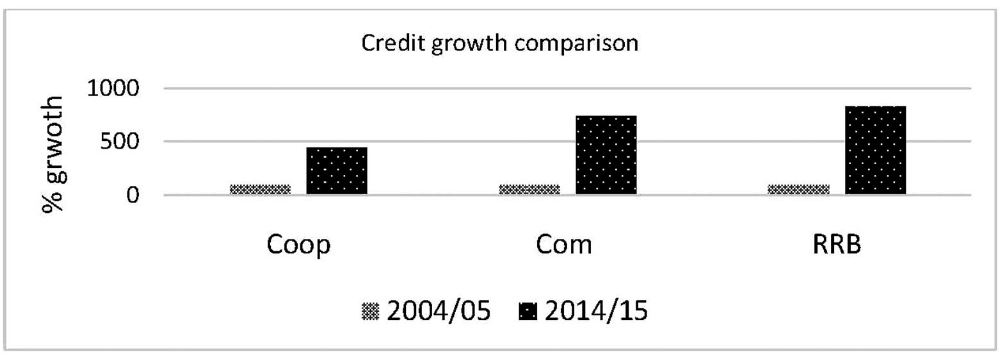

Figure 2. Share of Agencies in Credit Growth.

2.3 Yet the flow of credit may not be sufficient! Though the growth of flow and stock of credit for agriculture in the last decade has been impressive it must be stated that the overall involvement or exposure of commercial banks in agriculture is less than 7 per cent of their total assets whereas the share of deposit from rural areas is more at 13 per cent of total assets. RRBs and co-operative banks have a larger exposure to agricultural credit as per cent of their total assets but on a lower fund base. Together they contribute only 25 per cent of flow of agriculture credit. Net of refinance their exposure could be about 19 per cent of their working funds. The total outstanding of credit with commercial banks, as of March 2016, was Rs. 78,965 billion. Of this credit to agriculture and allied activities were only Rs.8829 billion; a mere 11.18 per cent of the total credit outstanding and less than 7 per cent[6] of the total assets. Indeed, agricultural credit flow has increased but clearly there remains much to be achieved! The size of banking in India is such that banks do not have any fund shortage to lend to agriculture and rural development. Apparently, reasons for poor credit outreach lies elsewhere.

2.4 Financial Inclusion will increase credit access. In the recent years, substantial progress has been recorded in increasing banking access under financial inclusion. As of March 2016, the number of rural branches was 51830, an increase of nearly 10000 branches since March 2015. In the last 5 years, nearly 5 lakh branchless banking units (BCs and USBs) have been established. Nearly 4 crore new basic savings accounts have been opened since 2010. Banks have been able to mobilise deposits of Rs 64,000 crore in these accounts.

The pivot for financial inclusion is banking technology. Today, every customer is encouraged to use digital banking and reduce cash transactions. Government is determined in using Aadhar and other digital initiatives for Direct Benefit Transfer of subsidies and subventions to recipients account.

All this will positively impact rural economy. From a credit perspective, build up in transactions in basic savings bank will build credit worthiness with these customers. Also, the issue of RuPay KCC cards which can be operated in Point of Sale (POS)/ATMs augurs well for rural credit.

2.5 Agriculture Continues to Depend on Monsoon: A lot of efforts have been taken by Government to increase irrigation potential in the country. Despite this irrigated agriculture (2015-16) is only about 47.6 of the net sown area[7] and majority of Indian agriculture is still dependent on monsoon. Adequate irrigation and economic size of land holding are critical for the success of bank credit. In the absence of legislation prohibiting sub-division below a level, average holding size continues to decline impacting the viability of the farms. These issues need to be sorted.

2.6 Crop Insurance does not cover all crops and full crop losses. Farmers suffer routinely from price risk and yield risk. Crop insurance is an absolute necessity for managing yield risk more importantly for small and marginal farmers who practice rain fed agriculture leading to a greater degree of yield variability and risk. Crop insurance schemes which have been implemented over years have all aimed to mitigate yield risk but have been found ineffective due to structural, design and financial problems. It is widely felt that it is ineffective because it is area based and covers only bank loan– not full loss and also it does not cover all crops.[8] "Problems of asymmetry of information—moral hazard and adverse selection—and co-variability are more pronounced in crop insurance than in other forms of insurance."[9] Government of India has recently launched Pradhan Mantri Fasal Bhima Yojana (PMFBY) replacing all previous schemes. PMFBY seeks to provide comprehensive cover at very low premia of 2 per cent of the insured value for the *kharif* crop and 1.5

per cent for the *rabi* season. Unlike previous schemes PMBFY will cover full crop losses. As of now yet this scheme has also not received very enthusiastic response as only 23[10] per cent of the farmers in *kharif* (2016) has been covered in the scheme. Crop insurance covers less than 40 per cent of crops/cropped area.[11]

2.7 Establishment of Warehouses has Improved the Scope for Produce Pledge Loans. In the recent years, many banks and NBFC's have started sanctioning produce pledge loans supported by collateral managers. It is reported that current volumes under produce pledge loans could be Rs 35000 crores.[12] Compared to the amount crop loans issued – which is but one third of produce value- at Rs 8.77 lakh crore the volume of produce pledge loans is not significant. Yet this is a growing product. Some of the following issues must be sorted for ensuring viability and growth of produce pledge loans.

- Currently Warehouse Receipts (WHR) are (a) not negotiable in most states and (b) not in electronic format. These two factors are critical for trade and successful delivery of contracts. These issues call for certain amendments in Central and State Acts which are in progress.
- Currently there are no price risk management (a) instruments and (b) markets due to which holder of WHR or producer is not able to fully manage price risk.
- Agricultural marketing continues to be the exclusive domain of members of market yards most of whom are grain merchants. Some market reforms have been initiated, but much more is needed. Farmer is not able to trade directly. There is a need to ensure/increase access of markets to farmers. Digital trade must be enabled. Markets should come out of the clutches of few traders who hold sway and achieve the originally intended objective of ensuring fair price and quick access to the farmer. National electronic spot markets should be allowed to trade in rural and urban commodity markets.

Produce pledge loans, have the potential to double the agriculture credit as also help in managing price risk. Pledge loans help in recovery of crop loans and avoiding NPA. It also ensures timely availability of funds to the farmer while waiting for appropriate price.

2.8 Farmers Producers Companies (FPOs) have been started: One of the recent initiatives in helping input and output management by farmers is the concept of FPO. The primary objective of FPO is mobilising farmers into member-owned producer organisations to enhance production, productivity and profitability of agriculturists, especially small farmers in the country. As of March, 2017[13] there were 586 registered Farmers Producers Organisations/Companies (FPO/C). More FPOs are being established. These FPO's function as aggregators for input supply and output marketing for farmers. Among others, sustainability of FPO's will be decided by efficiency of WHR and price risk related issues and designing a product for contract farming using FPO's as aggregators.

III

ISSUES IN AGRICULTURE AND RURAL CREDIT

The growth of agricultural credit has been impressive at the same time there exists scope for more credit. Banks have adequate funds. Then what constrains agriculture credit? Let's flag some issues.

3.1 Agriculture credit could be more if the co-operative banks are fully utilised. Despite a large network of co-operative banks (nearly one lakh Primary Agricultural Credit Societies (PACS) and 371 DCCBs) their share in agriculture credit is shrinking. This is due to poor fund availability, allegedly poor governance and high covariance risk with the sector coupled with regulatory/supervisory concerns. This has increased the expectation from commercial banks.

3.2 Commercial banks could do more. As of March 2015, agriculture and rural credit portfolio of commercial banks accounted for 51 per cent of total number of borrowers/ loan accounts but only 13 per cent of the credit outstanding. Within this, direct credit to rural areas (as on March 2015) was only 9.5 per cent of the net bank credit, of which agriculture accounted for 57 per cent and personal loans 16 per cent. The remaining, by deduction was for other rural credit activities. Obviously, credit flow is insufficient and there is a case to increase the overall credit flow to rural areas, more particularly agriculture and rural industries. The target for agriculture credit, both direct and indirect is 18 per cent of ANBC. It is observed that (as on March 2014) PSU banks had achieved only 16.5 per cent of ANBC. In case of private banks, it was only 14 per cent. It seems banks find it convenient to invest in priority sector bonds or RIDF.

3.3 There is a need to augment staff in rural branches. One of the reasons for poor flow of credit could be rural branch network and staff availability. Currently more than 5.6 lakh villages are served by less than 40 per cent of total branches and less than 15 per cent of ATMs are in rural areas (Table 1). This works out to 1 branch for 12 villages and 1 ATM for 30-40 villages. The average population served by a rural branch could be placed at a high 18000. The rural branch network is not sufficient. As regards staff it is seen that there were[14] 12,91,546 employees with commercial banks as of March 2015. Of this only 2,50,126 were in rural branches (19.36 per cent of the total staff). This works out to 5 employees per rural branch (many of them have just two or three staff) including one subordinate employee in rural areas as against an average of 10 employees per branch for the banking system. Thus less than 40 per cent of the branches and 20 per cent of the staff serve about 70 per cent of the population while 30 per cent of the urban and metro population is served by 60 per cent of the branches and 80 per cent of the staff. RRBs too suffer from staff inadequacy. Though a large rural BC network has been established, as of now BC's are used mostly for financial inclusion and not as much for agriculture credit delivery. Use of BC for recovery is happening. As augmenting staff appears not feasible, it is time more of rural banking is more speedily digitalised so that credit delivery can be strengthened.

TABLE 1. COMMERCIAL BANK BRANCH NETWORK IN INDIA - 2015

(1)	Rural (2)	Semi urban (3)	Urban (4)	Metro (5)	Total (6)
Centres	38280	6475	388	32	45175
Branches	48498	33703	22997	20474	125672
ATM	39572	57802	59293	55247	211914
Branch/s per centre	1.3	5	59	640	3
ATM/s per centre	1.0	9	153	1726	5

3.4. KCC should be improved. Currently most crop loans are extended in the form of KCC. However as against 12[15] crore farmers in the country there are only about 4 crore KCC card holders.[16] Possibly most small and marginal farmers may not be holding KCC. These farmers have to be issued KCC in order to achieve full credit inclusion. Further, it is important that farmers are able to use KCC in village input shop so that visits to branch for cash is minimised. For this village shops should be POS enabled and KCC should be an electronic card. As on date all KCC are not electronic card and most village shops are not POS enabled. It is for this reason that recently, Government of India has asked the banks to issue KCC in the form of Rupay Cards.[17] Government of India is also taking steps to augment POS in villages.

3.5 Risk management for rural credit: Farmers face many risks. Income volatility, yield risk and price risk are major among them. Among others absence of risk management tools and market are the reasons for high NPA's which in turn constrains growth of credit. Without doubt lack of risk managements and market are the reasons for high NPA's which in turn constrains growth of credit. As of now commodity futures and forward market products in agriculture are not available in the country. As such there are financial instruments or market for price risk management.

IV

PROCEDURE AND PROCESS RELATED ISSUES AND HOW THEY CONSTRAIN RURAL CREDIT

Banks adhere to a large number of legal and regulatory prescriptions, practices, rules, procedures and processes which have a strangle hold on their functioning and cripple decision making. What complicates things is that governments intervene frequently in agricultural credit which has implications for asset quality. Further, banks being resource rich are subject to heavy expectations about their involvement in agricultural credit. All these results in conditions and definitions. Definitions are necessary for carrying on business. Banks are no exception to this rule. Banks have strict terms of credit and definitions. These cover issues such as who is a small/marginal farmer? How much credit to extend? What is the scale of finance (SOF) and unit cost? What documents to take? (farmer has to produce copies of land records, cropping pattern from land records, No Due, No-overdue certificate, receipts for purchase, etc.). What repayments to stipulate? When should repayments be made? When can the account be rescheduled? When the account becomes NPA etc.

On each of the above issues there exist specific guidelines. To cut a long story short, in practice, nearly everything that a bank should/can do is defined or specifically stated. What is not defined cannot be done. If a farmer does not fall within the definitions he is refused credit. Nothing is left to the discretion of branches except denial of credit. Of course, refusal of credit should be recorded. The branch staff scrupulously follow guidelines as thumb rule or mandate. It would be very rare to come across instances where norms are relaxed to help a farmer. Those who do not come within norms are denied credit resulting in credit exclusion. The founder of SEWA bank Mrs Ela Bhatt had observed that one of the reasons for financial exclusion is Definitions (conditions). "Definitions EXCLUDE"! One may be poor, one may be deserving yet if one does not come within the definition one may not be eligible for credit. If a small farmer is defined as one with 2.5 acres of land owning 2.52 acres will make a farmer a big farmer which has implications for crop insurance premium!

4.1 *Guidelines on Credit and Definitions Tend to Limit Finance and Make It Inadequate*

Farmers who fit within the definitions/conditions could find the cost of complying with definitions and terms and conditions and producing acceptable documentary proof (proving eligibility) quite high and difficult. Studies have shown that farmers who are able to avail credit face many hurdles (see box 1) due to definitions and conditions related to operations in the account. In addition, after producing all documents the farmer may yet find credit inadequate. Inadequate because as per practice quantum of credit is based on lending norms (defined) and not need based. If banks face funds constrain it could lead to rationing of credit. For example, co-operative banks practice a rule of "Maximum Bank Finance Limit" per farmer. MBF helps co-operatives to issue loans to more members but members may not be financed in full. This results in a member borrowing from commercial bank and/or from informal sources and has implications for credit quality.

BOX 1

Anecdotal evidence suggests that a number of factors inhibit smooth credit delivery to the agriculture sector. These are: (i) insistence on collateral, (ii) complicated loan administration procedures, (iii) distances from the villages to the branches, (iv) higher monitoring and follow up costs, (v) culture gap between bank officials and farmers, (vi) political interference, (vii) inflexible lending policies and procedures including cumbersome documentation, (viii) difficulties in recoveries of overdue loans, (ix) lack of provision for consumption credit, (x) absence of effective systems for screening credit risks and, finally (xi) a misplaced belief that the borrowers in the agricultural sector, particularly, small and marginal farmers with low per capita incomes are risky and hence non-bankable.
Speech by Dr Duvvuri Subbarao, Governor RBI, at NABARD, Mumbai, 12 July 2012.

4.2.1 Crop loan amount is decided/limited by Scale of finance (SOF). SOF is the amount of loan required per hectare of a given crop arrived by bankers in District

Level Technical Committee (DLTC). SOF includes full fund requirements for inputs, irrigation, fertilisers, and labour cost for preparing the land, tilling, irrigating and harvesting. But actual credit extended is less than the amount arrived on the basis of cropping pattern and SOF as labour cost is excluded on the premise that it should be met (margin/down payment) by the farmer. This results in gap/shortage of funds more particularly with small and marginal farmers, most of whom double as agricultural labourers and may not have any other income or savings. This pushes farmers towards money lenders to meet the gap in funds at very high interest rates. Also, the money lender (who in most cases is a member of market yard and a trader) ensures that he has first claim on the sale proceeds of farmers' produces which impacts the viability of bank credit. In the case of investment credit for purchase of farm equipments etc., loan amounts are arrived after reducing a margin from predetermined unit costs. The farmer has to bring in the down payment/margin at times borrowing it from other sources.

4.2.2. A major portion of the amount of loan will be disbursed through cheques to fertiliser shops, pumpest dealers etc., to ensure end use.[18] Regulations, like laws apply to one and all. This has some unfortunate results. Take the case of misuse of credit. How many people misuse? Say 10 per cent, 15 per cent? Let's for argument sake take it at a high 40 per cent. How should banks manage it? Naturally, by tightening supervision, and having better borrower appraisal supported by quality borrower education. On the contrary, banks stipulate conditions to avoid misuse and make it applicable to one all even to those who did not misuse. One such condition is disbursing kind component. In early 1960's when farmers did not use fertiliser, kind component was a worthy idea. *Today fertiliser consumption is high/optimal.* This demonstrates the fact that the farmer is aware of what fertiliser to use and how much to use. There is no need for kind component.

Another practice is disbursing credit to the input/equipment vendors lest the farmer misuse. Why insist disbursal of loan to the fertiliser or pumpest purchase vendor? A vendor is a stranger to contract and consideration. It has been observed vendors vary the quality of inputs or give cash to the farmer after taking a discount. If farmers buy fertiliser, because banks issue cheque that takes time to clear, vendors do not offer normal discount offered on cash purchases.[19] Farmers discounting the cheque with the vendor cannot be ruled out. Unfortunately, regulation that credit should be disbursed to the vendor to prevent misuse prevail. It is based on the presumption that every farmer will misuse credit or will use poor quality fertiliser? It seems banker customer relationship on agriculture is built on MISTRUST.

In recent years most commercial banks allow farmers to draw money as he deems fit. Banks make cash disbursement or credit the loan amount to farmers' savings account. But it seems this is not the universal practice. Banks insist on invoice or other proof. Most of the co-operatives[20] and RRBs continue kind component mode. Currently KCC is not an electronic card due to which banks need to disburse cash or cheque each time the farmer needs fund. In the case of co-operatives, the fertiliser is supplied by the society which makes disbursement in kind component important for the viability of PACS. As the farmer has to repay the loan should he not decide where to buy input be his choice?

4.3. A farmer cannot sell his produce directly in the market which impacts his ability to repay in time: Every state has an agriculture and horticulture produce marketing Act which allows trade by members of the market yard. Most farmers have sell their produce through a member of the marketing yard/board. A farmer can become a member of the market yard but may not do for merely making one or two sales a year. There are 2,477 principal agricultural markets and 4,843 sub-markets (smaller than principal markets) that buy and sell agricultural produce in India. Yet it is reported that "On average, a farmer gets no more than 10 to 30 per cent of the cost you pay for his produce"[21] because of the restrictions placed by these laws. It should be added here that national stock and commodity futures markets on agricultural commodities have been in operation for more than two decades now. It is however disappointing that the volume of trades in agricultural commodity futures is very low. Electronic spot exchanges have also been set up. But these exchanges cannot become member of market yards unless the extant Rules in State Marketing Acts are amended. As on date most agricultural markets are run on archaic rules. Most of them do not have digital trade facility and electronic payment mechanisms only Karnataka has initiated E-mandis. Under National Agricultural Market (NAM) platform about 250 agricultural markets across the country (of 585 selected) were to be linked by 2015-16 to a common nationwide electronic platform. However, as of March 2016, only 21 markets in eight states have been linked. Thus though governments have been voicing concern there have been no serious efforts in making available a good marketing access/channel for the farmers. In view of this (a) price discovery is poor (b) farmers are forced to sell the goods through the grain merchant and (c) there exist certain delivery related issues which negatively impact the farmer.

4.4 *There is No istinction in Terms of Credit Between Small Loans and Big Loans*. All are put through the Same Process and Conditions. For example, whether one borrows Rs. 5000 or Rs. 5 lakh, the terms of credit (conditions) are same. The SOF does not factor economies of scale which adversely impacts small and marginal farmers. ROI is same up to Rs. 3 lakh (this leads to moral hazard in terms of (a) people restricting the loan to Rs. 3 lakh even if they need more and (b) some big farmers arbitraging borrowing with money lending. Disbursement is made in instalments as stipulated in SOF. This entails visit to the branch which adds cost to small loans. Banks do not vary the condition, despite distance of the farmer's village to branch etc. Insurance premium are per crop season basis. It must be added that some of the charges like inspection fee etc., are waived for small loans.

4.5 *Lack of Adequate Storage Facility*: What happens if a farmer has the capacity to wait and wants to store the produce till the expected price is reached? Banks can finance up to 75 per cent of the value of pledged produces. Banks can also lend against warehouse receipts. For this good quality warehouse facilities are needed.

Warehouses should be able to issue a negotiable warehouse receipt (WHR). Of late the availability of warehouse facility is increasing thanks to the efforts of Warehouse Development Authority. Further NABARD extends funding support for creating warehouses. The authorities are also working on the twin issues of negotiability of warehouse receipts and enabling electronic trading of warehouse receipts, which if implemented will be a boon to the farmer. States must recognise these warehouses and electronic record of sale and allow trade to take place outside the market yard. They must allow membership of market yard to electronic spot markets. This will reduce the stranglehold that grain merchants hold over this market and lead to better price discovery for the farmers.

4.6 *The Current Procedures for Re-Phasement and Rescheduling of Loan are Tedious and Ineffective*. When crop losses occur due to natural calamities or otherwise farmers' cash flow is badly impacted and it is difficult to service the loan. Needless to add that in the absence of funds, it is difficult to take up cultivation of next crop. In view of this, efficient crop insurance scheme, credit support in the form of rollover or rescheduling of current loan and extending fresh credit for taking up next crop cases is very important. Banks will also need fund support or refinance lest they are short of liquidity.

In these cases, as per current practice farmers are offered (i) a facility to convert short term (crop loan) loan into medium term loan, (ii) rephasing and/or rescheduling of instalments in case there exists some term loans and (iii) fresh crop loan for the new crop. This ensures that flow of credit and also that farmers debt service is complete.

Is this viable? Consider the case of a farmer who has availed a crop loan and a term loan for purchase of a pumpest. If he suffers crop losses on account of drought and takes a third loan for converting the crop loan into a medium-term what will be his DSCR for the next crop season? Generally, SOF is about 40 per cent - 50 per cent of the value of produce. That means, if a crop is not affected, including interest, servicing of crop loan will account for about 50 per cent of sales realisation. Servicing of pumpest loan will involve say another 10 per cent of the sales realisation. There could be other loan or interest repayment commitments. Thus, even in normal years a farmer could face tight liquidity situation. Given this will he be able to afford a conversion loan? No obviously not. What is needed is insurance and full indemnity for losses. But what is available is rescheduling or conversion of a loan so that crop loan is not in default and fresh crop loan can be issued. The burden of loss remains with the farmer leading to distress.

4.6.1 Conversion loan is, however not easy. This is because banks will not allow conversion facilities unless the district authorities declare 50 per cent loss on anewari basis. Anewari is a legacy from British era when it was used to offer land revenue waiver to the farmers. This system was adopted by Agricultural Credit Department of RBI for the purpose of allowing conversion loans. Anewari[22] is a revenue process. It is an announcement of waiver of government cess or revenue. Anewari is declared based on crop cutting statistics. But as the land revenue has not been revised for ages and is almost 100 per cent collected (it is insignificant to the farmer as well) most district authorities would rather not declare low Anewari. As such, in recent years anewari never gets declared.

The most important issue in all this is how to prove a drought if the anewari or percentage of crop loss is not declared by the district administration. Is this really an issue one may wonder? Does this impact rural credit? The importance of this issue can be inferred from the doubling of credit announcement made by the Finance Minister[23] in the year 2004. To implement this RBI and NABARD have issued circulars asking banks to restructure almost all crop loans and other agricultural loans for farmers on account of (i) natural calamities they suffered but banking system could not support due to inadequacies such as non-declaration of drought/flood etc., and (ii) farmers who were distressed on account of other reasons. This involved large financial outlays and NABARD had extended additional funds to co-opreratives and RRBs to tide over the liquidity issues, if any, on account of conversion and rescheduling denotes ample proof on practical issues and ineffectiveness of anewari system for managing distress in agricultural credit.

4.6.2. Ultimately conversion may not be a viable option for the farmer*:* Let us carry forward the case of the farmer discussed above. With conversion, a farmer will have three loans (i) a crop loan (KCC limit) for the current year, (ii) the pumpest loan where the instalment has been postponed due to natural calamity and (iii) a conversion loan for an amount equal to the previous crop loan and interest due. As described earlier, for the first two loans his debt service was about say 60 per cent. A conversion loan is a medium-term loan repayable in 5 or 7 annual instalments. With conversion loan farmer's debt service will come to about 80 per cent of his annual cashflow including one annual instalment (1/5th or 1/7th of the loan amount) on conversion loan. Clearly conversion loan is unviable. Loss cannot be managed by a loan! On conversion, the crop loan is no more in default. Bank continues to earn interest on all three loans whereas the farmer is distressed. Of course, the farmer is able to continue farming. Hopefully the next crop will be better! Conversion loan could be avoided or reduced if crop insurance goes to wipe of the entire crop loss, including the bank loan suffered by the farmer on account of natural calamity. What is needed is a combination of crop insurance and conversion and a derivative instrument to protect price risk. Insurance should be timely and should ensure that farmer does not have to initially fund the loss and wait for insurance settlement.

V

ADEQUACY COST OF CREDIT AND OTHER ISSUES

We have, in the above seen the status of credit and various initiatives. Let us now see how the farmer is impacted on account of Terms of Credit and some of these initiatives.

5.1 *Repayments are Stipulated Narrowly*. Banks sanction cash credit to a business in the form of a limit which can be operated on the drawing power arrived as a per cent value of hypothecated security. Though a farmer hypothecates his standing crop and agricultural produce, KCC has no drawing limit stipulation. Repayments under KCC are so stipulated that the farmer has to return the money borrowed at the end of the season, immediately after harvest or within one year from the drawing of funds. Thus, unlike commercial credit where cash credit limit is perennial subject to annual review and availability of hypothecated goods or mortgage farmer is forced to operate KCC like a 9-month (crop season wise) or one year loan while the limit is available for 5 years. Once the repayment is made KCC holders can draw funds/money within say a week or ten days. It is learnt that banks disburse credit on the same day when a farmer repays without waiting for 10 days. Thus it appears that repayments are stipulated merely to demonstrate financial discipline. Even in respect of farmers who have a good track record with a bank say for 10 years' repayment stipulations are not relaxed. Such rigid norms are hard on the farmers most of who have to manage *throughout the year cash outflows (getting the land ready, fertilising it, irrigating it, planting the seedlings and harvesting, power, meeting own expenses etc.) whereas inflows are only one or two depending on when the crop is marketed.* As soon as an inflow is received it is used to repay bank loans and other loans, meeting household expenses and getting the farm ready for next crop. No wonder farmers face continuous liquidity crunch and most of them are constrained to borrow from market middlemen or money lenders. This is possibly why money lender is ubiquitous.

If the idea behind repayment is only to re-issue loan after 10 days, why not accept interest payment, review limit and continue the loan rather than insisting on repayment and reissue which have a cost for both banks and the borrower? Why not allow the farmer to operate KCC account like CC/OD accounts which are given to SME and companies where in banks recover only interest and not principal so long as drawing limit is in force? It will be a major boost to agriculture and help manage NPA if KCC is made a 10-year limit with only interest to be paid during the year and principal to be repaid on review or demand. To start with even in current 5 year KCC farmers could be asked to pay only interest and such principal as he could afford which will help in reducing interest burden. More importantly this will reduce government interventions. This will lead to a less cash economy and help farmer manage his fund flows more efficiently.

5.2 *The Effective Cost of Small Loans is Much Higher than Big Loans*[24]: A farmer incurs many costs other than interest, insurance and bank charges in availing credit. These are (a) travel costs on visiting to the bank branch for sanction, disbursement, repayment etc. the number of visits are decided by disbursement and repayment stipulations as also the need to operate the accounts. Cash credit has the inherent benefit of reduced quantum of interest if the transactions are frequent and done through cheque or card. This is not currently possible necessitating visit to the branches. Thus, benefit cash credit is negated as visits to the branch increases the cost. (b) cost of getting the mandatory “No Due” or “No Overdue Certificate” from branches/PACS around the area involve some formal and informal expenses, (c) crop insurance premium which is levied every season and based on definition of small or big farmer and not on quantum of loan and (d) cost of stamps and documents which is the same irrespective of loan amount. Mortgage (stamp fee) adds to the cost depending on the loan amount.

In a way these are fixed costs. As a result, cost of borrowing (travel expenses + interest + insurance premium + other expenses + discounts lost due to bank procedures etc.) as a per cent of loan amount/limit of small loans is much higher than bigger loans. No wonder, cost of credit gets reduced substantially as the size of loan increases or the cost of credit is higher on small loans.[25] This high cost coupled with long procedures could be the reason for small and marginal farmers not approaching banks for small agriculture loans. Though they pay higher interest to money lender it is door step and hassle free. Also, they are not sure if banks will lend to them.

In the circumstances, there is a strong case to give a composite and a higher size loan to the small farmers. Currently banks are not able to do so because of the need to arrive at loan amounts on the basis of SOF. Why not give larger loans to small farmers on a LTV based on land owned or leased, on a fixed sum say Rs. 20,000 per hectare?

Another approach could be formation of JLG’s of farmers wherein the JLG limit could be more than the sum of individual (eligibility based) limits. FPO’s could be encouraged to form JLG of its farmer members and seek loans from banks. This will result in larger flow of credit and cost reduction as fixed costs get spread over a higher group loan volume.

5.3 There is no mechanism to manage price risk. Price risk is an important issue. Agriculture credit needs the support of crop loan forward contract (like forex forward) which, if introduced, will be an instrument to manage price risk. This will enable a farmer, when he takes a loan, to buy protection against a downward movement of price when the produce comes to the market. Banks which issue a loan could also sell a crop forward contract to the farmer. The protection price (futures price) could be determined by refereeing to the National Commodity Futures Exchanges. Similarly, a buyer of the produce should be able to seek protection against an upward price movement based on commodity market driven future price. An important requirement for this, as mentioned above is the warehouse facility. Warehouse facility will help the farmer to store the goods. Warehouses will also ensure delivery of contracts. These in turn will ensure price risk management for the farmers. Banks who finance both the farmer and the grain merchant in turn can also hedge themselves in both cases. Such contracts will help develop a deep and efficient commodity futures market. This coupled with good crop insurance will ensure risk mitigation for the farmer and banker. NPAs’ will come down drastically. There will be no need for subvention from the government. This issue has been debated for a long time now and yet things are not moving forward. The Securities and Exchange

Board of India (SEBI) on 13th June 2017 announced rules for the introduction of commodity options. The regulator said it would allow only one commodity option per exchange on a pilot basis. Let us hope this will quickly be extended to all commodities.

5.4 *Norms Prohibiting Collateral Ends Up in Refusal or Reduced Loan Volumes*: This is a contentious issue. By nature, banks prefer secured loans whereas Governments and Regulator prohibit collaterals for loans below a prescribed amount as it could end up denying credit. As against this the rapid increase in home loans where mortgage is allowed clearly demonstrates the fact that banks issue more priority loans if it is secured. In this background, it appears that no collateral norm has possibly resulted in limiting bank's exposure to agriculture not more than the extent mandated and also caused NPA's. This can be inferred from the fact that banks have, in the last more than 3 decades never exceeded agriculture credit targets. On the other hand, they have invested in RIDF to cover the shortfalls. There are nearly 12 Crore farmers and achieving 18 per cent target of adjusted net bank credit for agriculture should not be difficult. Shortfall in targets for agriculture credit points out how much disinclined banks are towards crop loan and agriculture credit.

One of the constraints is mortgage or collateral. Why no mortgage? Because regulator thinks that it ends up denying credit. Actually, this could be a huge misconception. Microfinance is an example of how incidence of risk has been pushed to the lowest possible level yet people are willing to borrow. Interest rate and mortgage are not issues. Availability of credit is the most important issue. Is mortgage a constraint? Housing loans have clearly demonstrated it is not. If a farmer is given a choice of (a) no credit without mortgage or (b) assured credit with mortgage he will in all probability choose the latter. Mortgage is not a problem, for the farmers know that even if the banks have mortgage they cannot sell the land![26] Farmer has been pledging his valuables and land to the money lender. Why would he deny it to the bank if only he is offered better terms and adequate credit? Credit should not be denied is the reason why mortgages are not allowed. Is this objective achieved? We need to debate and study this aspect.

Given the difficulty in enforceability of mortgage, why banks avoid unsecured loans? Primary reason is not that security enables negotiating recovery with the borrower which is a huge help in recovery and containing NPA. It is recognised that no coercion or force could be used for recovery. At the same time lack of security could induce default. The recent trend of increased defaults in SME and MUDRA loans where collaterals are not allowed is a pointer to the need for collaterals.

If the objective is flow of credit then there is a need to allow collateral for agriculture/rural credit and arriving at the loan amount on the basis of security value. This will also help to overcome the shortcomings of SOF related credit gaps and make available sufficient funds with the small farmers to invest and grow. In such lending seasonality based repayment norms are not needed and farmer can be given more freedom to manage cash flows.

Will the farmer like secured loans? The relative ease with which private banks and NBFC's are lending to agriculture with security has shown that secured loans are possible in rural credit. Farmers will be ready to deal with a banker than a money lender if terms of credit are reasonable and credit delivery is quick. Of course, there could be initial resistance when mortgage is reintroduced by PSU banks. It will get offset when the loan amount is reasonable. To start with there could a separate mortgage based agri-credit scheme for small and marginal farmers.

5.5 *Unviable Holding and Small Ticket Loans*: In the case of small holdings bank loans become unviable. Further, smaller loans are costlier to the borrower than bigger loans. Banks also find small ticket loans difficult to supervise as cost of supervision is higher.

As indicated previously mortgage based lending is one method to increase the amount of loan availability to the farmer. Another method of making small loans viable is group lending. Group lending for productive purposes can be made through Joint Liability Groups (JLG). Banks, however have not recorded much progress in JLG for crop loans. This is because the terms of JLG are not attractive. To make it attractive and useful banks may consider the following:

(a) Banks may sanction a higher credit limit under JLG. For example, if there are 4 farmers each owning one acre of land and eligible for a limit of Rs 10000 each (SOF based) come together as JLG banks should sanction say Rs. 60,000 instead of Rs. 40,000. This is because the loan is collateralised due to group guarantee. The additional loan amount will make borrowing viable and will enthuse farmers to form JLG. Bank will save on cost of delivery as it will be one JLG account with sub-limits for all members. SHG bank linkage has already demonstrated huge success of group movement.

5.6 *Crop Loan Procedures are Lengthy and Difficult. SOF Varies from Place to Place*: Farmers are not accessing credit due to procedural constraints. Banks also find the procedure lengthy. In this regard, it will be worthwhile to develop crop loan product on the lines of a retail loan. The farmer's KYC could be completed with Aadhaar and land records. Once this is done he may be given loan on a per acre basis rather than SOF on cropping pattern basis. The loans could be on a loan to value ratio basis or fixed obligation to income ratio basis with or without mortgage. This will speed up the issue of loans as it is easy for banks to appraise.

5.6.1 *Higher Default and NPA*: The NPA on agricultural loans with co-operatives is around 10.5 per cent and it is 8.5 per cent with commercial banks. There are a number of reasons for default. Drought, flood, emergency expenses etc., could derail farmers' cash flow and result in default. Farmer facing difficulty to market and price risk is not uncommon. Currently only yield risk is managed through crop insurance but there are no risk management tools/instruments/system for managing other risks. All these impact cash flows and result in NPA delinquency.

5.6.2 *Credit/Loan Guarantee Scheme for Price Risk*: A well-managed credit guarantee will help in managing NPAs. Currently MSME loans are covered[27] (Rs. 2 crore) by credit guarantee schemes. A similar scheme could be tried for farm loans. NABARD may start a loan guarantee scheme on a contribution basis. This fund can be started with NRC stabilisation fund which remains unused with NABARD. Commercial banks can also contribute to the initial corpus of fund. This guarantee could be used for all loan defaults due to price and other but not yield risk while should be covered by an improved crop insurance scheme. Credit Guarantee will complement crop insurance and make it viable.

Another measure is, as s mentioned earlier (a) augmenting produce pledge loans by encouraging collateral management schemes. This will help in recoveries and managing debt service and (b) introduction of crop futures or forward in Commodity Derivative Market where farmers or banks on behalf of farmers could take hedge against price risk will also help in containing NPA.

VI

CONCLUSION

There is no denying the fact that agricultural credit in India is growing. Yet credit exclusion among farmers is high. Agricultural credit is seriously constrained due to insufficient and poorly staffed rural branch outlets, inadequate quantum of loan, lengthy procedures, poorly executed crop insurance, treating farmer with a beneficiary mindset, lack of market access to farmer’s produce leading him to the clutches of money lender, lack of good warehousing facilities, absence of negotiability of WHR, lack of price risk management hedges, etc. There exists a large number of regulatory/supervisory guidelines on rural credit. Instead of augmenting credit which is the objective of regulation, these have in fact resulted in a closed mindset with bankers, and lengthy credit processes and procedures. Banks need more freedom to take credit decisions. Agricultural credit is vulnerable to vagaries of weather which causes NPA. NPA cannot be managed through repeated doses of OTS. Farmers and banks much hedge credit risks in commodity market. There is an urgent need to introduce risk management instruments and market to manage price risk. Productisation of agriculture credit could be considered. Rural banking is, currently, lagging substantially behind urban and metro banking in terms of productisation of credit, ATM, POS machines, infrastructure and staff strength. More technology has to be moved to rural branches. It is time all these issues are addressed holistically and new procedures adopted so that quality and quantum of agriculture credit can increase leading to greater prosperity.

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NOTES

1. http://www.internetlivestats.com/internet-users/india
2. RBI data.
3. Despite two decades of its introduction KCC is used by (or given to) by less than 4 crore Farmers. The data on KCC which says there are about 10 crore KCC's talks about cumulative number of KCCs not outstanding accounts! There are more 11.89 crore farmers in India.
4. NABARD data.
5. Despite two decades of its introduction KCC is used by approximately 4.6 crore Farmers only (Table 5.1 Progress made under financial inclusion plans – as on September 2016 RB Trends and Progress of banking in India-2016) as against this there are more 11.89 crore farmers in India (census 2011
6. *State of Indian Agriculture 2015-16*, Ministry of Agriculture and Farmer's Welfare, Government of India.
7. However, the Scheme could not provide desirable results due to some constraints, mostly operational, faced in implementation of schemes. These constraints include inadequate infrastructure at field to conduct requisite number of crop cutting experiments (CCEs), delay in settlement of admissible claims on account of late submission of yield data by the state, delay in release of State share towards its committed financial liabilities, phasing out of premium subsidy (to S/M farmers), larger unit areas of insurance (high basis risk), little interest shown by the financial institutions (insurance underwiring point), lower level of indemnity, inadequate Guaranteed yield to compensate adequately, noncoverage of perennial horticultural/commercial crops, risks of prevented sowing & post-harvest losses etc. The Scheme could not translate into actuarial regime as conceptualised. Government has also faced difficulties in their budgeting due to open ended financial liabilities on account of premium subsidy, claims, administrative expenses, bank service charges, publicity expenses etc. (*State of Indian Agriculture* 2015-16 pp. 95).
8. Report of the Committee to review the implementation of crop insurance schemes in India -2014 preface.
9. Livemint Nov 29 2016.
10. According to FM the coverage of this scheme will be increased from 30 per cent of cropped area in 2016-17 to 40 per cent in 2017-18 and 50 per cent in 2018-19, Financial Express January 1, 2017.
11. "Warehouse receipt financing is now Rs 35,000 crore business, up from roughly Rs 5,000 crore a decade ago. With better policy execution and farmer awareness, it has the potential to grow up to Rs 1 lakh crore by 2020," *Business Standard* June 15.
12. Source SFAC.
13. Bank and Group and population group wise distribution of employees of scheduled banks according to category as of March 2015.
14. As per Census report 2011 the total farmers or cultivators population of India is 118.7 million (2011).
15. Pg118 Kisan Credit card evolution and prospects. Published by Macmillan. R. Bhaskaran.
16. Government of India Finance Bill 2017 speech. More than 3 crore KCC cards to be issued in RuPAY card format.
17. 3rd R K Talwar Memorial Talk organised by IIBF 23rd July 2009.
18. Study of M-KCC for NABARD at Valluvar Gramin Bank, Vellore Tamil Nadu. Report by Dr. R. Bhaskaran.
19. http://rcsharyana.gov.in/loans-advances.htm.
20. http://www.rediff.com/business/special/special-indias-biggest-farm-reform-is-916-behind-target/20160419.htm.
21. http://indiabudget.nic.in/es2004-05/chapt2005/chap810.pdf:Box 8.5: Initiatives taken in June 2004 to enhance credit flow to agriculture.
22. *Anewari*: Before the metric system of paise and rupee 16 anna's made a rupee. 75 per cent of 16 anna is 12 anna. Crop loss of 50 per cent means 6 annas a rupee. If the district administration declares crop yield as anything less than 6 annas farmer's revenue dues were waived. RBI had, in the early years of agriculture financing taken this as a basic input for conversion loans)
23. Pg.200-201 Kisan Credit card evolution and prospects. Dr. R. Bhaskaran. Published by Macmillan.
24. Ibid The above study has recorded that the cost of borrowing for small loans is as high as 18 to 20 per cent despite the fact the banks were charging only 7 per cent on loans (2011-12). Today, given the interest subvention the interest rate may be further low but the cost difference between a Rs 3 lakh crop loan and Rs. 20,000 crop loan could be 8-10 per cent.
25. Microfinance has already made it a cliché "what is important is availability of credit not the rate of interest or cost" It does make an important point that availability of credit is important and interest rate is not.
26. Finance Bill 2017.
27. The increase in guarantee cover from Rs 1 crore to 2 crore has been announced by CGTMSE Circular No.121/2016-17, January 09, 2017.