REPORT OF THE HIGH-LEVEL COMMITTEE ON AGRICULTURAL CREDIT THROUGH COMMERCIAL BANKS—SUMMARY OF RECOMMENDATIONS*

In recent years a perception has grown that investments in agriculture have not kept pace with demand despite increase in the flow of credit to the agriculture. In this backdrop and also in the context of priority accorded to agriculture and to give an impetus to the flow of credit, the Reserve Bank of India set up a one man High-Level Committee headed by Shri.R.V.Gupta on Agricultural Credit Through Commercial Banks in December 1997 to suggest measures for improving the credit delivery systems as well as simplification of procedures for agricultural credit. The Committee's mandate was to identify the constraints faced by commercial banks in increasing the flow of credit, introducing new loan products and services, and simplifying procedures and methods of working with a view to enabling rural borrowers to access adequate and timely credit from the commercial banks.

Terms of Reference

(a) To study the working of the credit delivery system for agriculture through field level interaction with farmers, agriculturists, borrowers of commercial banks and bank staff and analyse the constraints in the flow of such credit to the farm sector.

(b) To make suggestions for simplification and improvements in systems and procedures including reduction in paper work for delivery of farm credit.

(c) To make proposals on other initiatives that may be taken by commercial banks to facilitate credit delivery to the farm sector.

In view of the task assigned and the short time at its disposal, the approach formulated by the Committee was to obtain structured response from commercial banks and interaction with farmer-borrowers, bank and Govenment officials, agricultural scientists, extension workers and representatives of farmers associations in different parts of the country.

The Committee submitted its Report on April 21, 1998.

Summary of Recommendations

1. The agreements and other convenants/ documents to be completed are complicated and therefore simplification is recommended as has been done by some banks, such as the State Bank of India. All banks may examine their systems and make modifications within two months, and report compliance to the Reserve Bank of India.

2. The focus of credit appraisal should be on evaluation of the income stream of the borrower, and a comprehensive assessment of credit needs taking into account track record, credibility, capability, as well as technical viability of the proposal.

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* The summary has been prepared in the Division of Rural Economics in the Department of Economic Analysis and Policy.

3. To ensure quick disposal, at least 90 per cent of loan applications should be decided at the branch level. Banks may, therefore, review the position and suitably modify the powers of sanction delegated to the branch manager.

4. Short term credit needs of the farmer should include all requirements directly and indirectly related to production, post harvest and household expenses. Repayment capacity should be assessed on the basis of aggregate household income from all sources including crop production and ancillary activities. The credit facility should be extended through a composite cash credit limit. The limit may initially be provided for one year but over time extended for a longer period and brought to credit atleast once a year. On credit balances banks would pay interest, and charge interest on the oustandings. Advances under such limits may be 'reckoned' as advances to agriculture within the definition of priority sector.

5. In line with the change in approach towards appraisal of loan proposals for lending recommended by the Committee, the forms accompanying the main application, especially, for investment credit should be simplified and made more relevant for focussing on the income stream of the farmer. It is recommended that the Reserve Bank of India may appoint an expert group to finalise the new forms.

6. While some minor investments of a medium term nature can be taken into account in the composite cash credit limit recommended above, investments of a major nature would still need a separate loan. In relation to the systems followed for term lending, the emphasis should be on whether in a given area an activity can be supported profitably, rather than obtaining abstract cash flows and other data based on projected technical parameters.

7. During cash rich periods, farmers have a propensity to invest in gold, land, implements, livestock or incur expenditure of a consumption nature. As a result they are vulnerable during times of adverse price fluctuations and natural calamities. To address the issue farmers should be offered a liquid savings product with an appropriate return which should be inbuilt in the loan product so as to provide them a cushion during lean periods.

8. The system of adoption of scales of finance for short term loans and unit cost of investment credit has led to distortions at the base level and introduced an element of rigidity in assessment of credit requirements. In view of the expertise developed by banks in financing agricultural operations, and in order to give them flexibility to take care of variations in the requirements of borrowers, the fixing of the scale of finance/unit cost may be decided by the concerned banks.

9. The system of disbursing agricultural loans, partly in cash and partly in kind has restricted borrower's choice and given rise to undesirable practices including submission of false bills and receipts. In order to foster an environment of trust, banks may disburse loans for agricultural activities on a cash basis only and discontinue the practice of obtaining bills/receipts of inputs/assets purchased.

10. Insistence on No Dues Certificate (NDC) as an invariable precondition for sanctioning a loan is unnecessary and time consuming. Where banks are conversant with the track record of the borrowers, obtaining a NDC should be left to the discretion of the lending banker.

11. Without recovery at acceptable levels lending cannot be sustained. Recovery of dues has issues which are legal, administrative, as well as in which publicity is necessary. Specific recommendations include requesting State Governments to set apart dedicated teams for recovery, improving the recovery climate through rurally oriented field publicity campaigns projecting the message that banks are willing to lend to viable borrowers, and unless funds are recycled lasting relationships cannot be forged through the credit mechanism.

The accounting systems in banks need to focus on systems by which recovery is disaggregated by loan products, as well as by time so that it is possible for managers to determine which products are more viable and whether current recoveries are better than past dues. The branch managers also need to have a statement of defaulting borrowers more promptly than is possible under the existing procedure.

12. Apart from steps for improving collection of dues, the Committee recommends that tangible incentives be provided to farmers who are prompt in repayment. Banks should design appropriate incentive systems including interest benefit or rebate to borrowers who repay their dues promptly. Besides incentives for prompt repayment, farmers who opt for a savings module linked to the loan product, may be given a finer rate both on the loan as well as on the savings product.

13. Taking into account the procedural difficulties and the high cost of stamp duty connected with registering a mortgage in favour of a bank, State Governments may initiate steps to abolish stamp duty on mortgage of agricultural land for obtaining loans from banks.

14. Unlike in urban areas, most land in rural areas is inherited and there are no title deeds. The original land records in the tehsil office are similar to a share depository and if a farmer has a pass book with an authenticated record of his land holding, the bank should accept the same as valid title for purposes of an equitable mortgage.

15. In States where the Agricultural Credit Operations and Miscellaneous Provisions (Banks) Acts have been passed, bank loans should be secured through the mechanism of the declarations prescribed thereunder. States which have not passed the above legislation may consider doing so. In the interim, such States may issue administrative orders that declarations made by borrowers on the Talwar Committee model for charging their lands to banks may be noted in the revenue records so that banks can lend against the same.

16. The value of security taken should be commensurate with the size of the loan and the tendency to ask for additional collateral by way of guarantors where the land has already been mortgaged should be discouraged.

17. In order to give operational flexibility to the lending banker, margin, security and collateral requirements should not be prescribed by RBI or any other agency and should be left to the discretion of the lending banker. For small loans upto Rs. 10,000, however, the existing guidelines may continue.

18. The requirement to insure all assets purchased through bank loans is an imposition causing financial hardship to borrowers. The decision as to the kind of insurance to be taken should be left to the borrowers subject to statutory requirements.

19. In order to inform farmers transparently of the amount and periodicity of the various fees and charges levied by banks, they should be given a statement of the facilities availed, separately indicating the fees, charges, etc. levied. The instructions regarding compounding of interest issued by RBI may be reiterated so as to ensure that these are invariably followed.

20. The internal supervision system of banks should provide for visits to a few service area villages and during such visits, inspecting officer should convene open meetings of farmers to assess their problems and difficulties. The CMDs of banks, during their tours to various States, should pay surprise visits to rural branches as this would provide top management with an idea of field level conditions.

21. A large portion of the branch manager's time is spent on compiling returns of various descriptions for different agencies. There is an urgent need to rationalise number of returns and a detailed exercise should immediately be undertaken by banks to reduce unnecessary paper work including elimination of *ad hoc* returns which very often require data already provided elsewhere. In this context the MIS for monitoring agriculture and other advances developed by the Bank of Baroda may be taken as an example.

22. Notwithstanding exceptions to the contrary, the morale of the rural cadre in commercial banks is low, commitment uneven and the sense of mission weak. This has to be addressed if rural lending is to be stepped up.

23. The Government of India stipulation for a compulsory rural posting may be done away with and posting of staff to rural centres should be based on institutional needs to be decided by the management of banks.

24. The performance appraisal system in vogue in commercial banks for rural branches should be revamped with a substantially reduced weightage for deposit mobilisation. The appropriate indicators for performance measurement should be increase in outreach, measured by the number of new clients, volume of lending, assessed on the basis of incremental increase in the flow of credit and loan recovery as indicated by the volume of cash recoveries.

25. To bring about the desired behavioural change in rural lending and to strengthen the sense of mission of bank staff, a package of incentives encompassing foreign exposure, training in prestigious institutions within the country, weightage in promotion, posting to centre of choice, improvement in accommodation and educational facilities and corporate recognition of outstanding performance is recommended. These incentives are indicative and banks may evolve their own schemes for improving the morale of rural branch managers.

26. Training institutions of banks need to design fresh interventions shifting their focus from the present activity specific/ project based training programmes to those emphasising borrower appraisal including techniques for asessing the needs of the rural household in a holistic way *vis a vis* the income stream/repayment capacity.

27. 'On the job' exposure should be made a major training vehicle for new staff duly supplemented by formal training. The approach of Grameen Bank in making the trainees internalise the bank's philosophy of rural lending and poverty alleviation may be

adopted with appropriate modifications to suit the Indian context.

28. The non-farm sector has a large unutilised credit absorptive capacity. Rural households generally pursue a number of activities, both agricultural and non-agricultural, for supplementing their cash flows. These activities have modest working capital requirements and banks should design specific loan products for such activities by providing loans for short period upto three months, initially with weekly or fortnightly repayments. At the end of the period repeat loans for higher amounts and for longer periods could be offered depending on the repayment behaviour with inbuilt incentives by way of interest rebate on prompt payment.

29. Self Help Groups (SHGs) have proved effective intermediaries for the transmission of bank loans. Banks should give wide publicity to their preference for financing SHGs, sentisize regional heads and branch managers to the potential for good lending through this route, and provide training to branch managers in assessing the potential of SHGs and simplification of documents.

30. The Reserve Bank of India may direct banks to adopt the model set of documents prescribed by the Working Group on Non-Governmental Organisations and SHGs set up by RBI in 1994 pertaining to agreements between members, loan formats, application forms, etc.

31. Upgradation of infrastructural facilities especially village market yards, rural roads and stable power supply will go a long way in expanding credit flow to the rural sector. The responsibility for maintaining public sector infrastructure should, where possible, be entrusted to local initiative.

32. The efficacy of credit depends on the extent and quality of integration between infrastructural facilities, technological innovations, research and extension support. Linkages should be forged and strengthened between extension workers, faculty of agricultural colleges, branch managers and Government departments at the local level through the various district fora.

33. There is a need for branch managers to have a broad knowledge of agriculture and related activities. At many places, farmers are confused about the type of inputs to be used for crops and can be misled by input dealers/other suppliers. Banks should work out a system by which, information regarding the package of recommended practices for the cultivation of crops specific to their areas is disseminated on a regular basis.

34. There should be greater involvement of panchayats in agricultural extension including provision of training facilities to volunteers and creation of user groups of farmers for acting as nodes for technology transfer. Wherever possible, rural branches should link up their activities with Farmers' Clubs initiated by NABARD.

35. Corporate offices of banks may quickly undertake a review of the functioning of their hi-tech branches, especially to identify those which are not working well due to inadequate expertise and/or lack of demand. The hi-tech branches of banks should also be used to disseminate information relating to agricultural operations and specifically for providing technical information regarding cultivation of high value crops.

36. The rescheduling of a loan instalment during times of natural calamities specifically in regard to a term loan should be based on

the bank's assessment and should not inhibit the bank from extending short-term production credit to the farmer.

37. In case of production credit, especially for farmers cultivating high value cash crops, a savings component should be built into the loan product to provide cushion during times of distress. The saving-loan linkage should be encouraged by offering a finer rate on the loan.

38. Timeliness and adequacy of credit are critical to increasing the credit flow to agriculture. Small loans involve higher transaction and administrative costs. As a result, managers tend to look for larger loans where interest rates are deregulated, while banks seek to equalise the price differential by cross subsidisation. In effect, therefore, regulated rates of interest operate as a barrier to the sanction of small loans. As has already been done in the case of co-operatives and RRBs, commercial banks should be free to fix the rates of interest for loans of all amounts.

39. It was observed that the loan portfolios of banks linked to subsidy were usually sub-standard with recoveries below 30 per cent while in regard to loans sanctioned according to the business judgement of bankers recoveries were excellent. In the implementation of subsidy linked credit schemes, emphasis usually was on achievement of targets and the quality of lending as well as impact of such schemes was very poor.

A thorough review of existing systems is recommended as subsidy linked lending has proved unsuccessful and needs to be replaced by an alternative method. The Committee believes that the rural poor are viable and borrowers can be directly targetted by commercial banks through NGO/SHG intermediation coupled with extended micro credit working capital facilities to the non farm sector. There is adequate experience in India, as well as internationally that such lending can be done profitably on a large scale given certain preconditions such as customer sensitive loan products, appraisal of projects consistent with assessment of borrowers, full discretion in selection, improved methods of working and better follow-up after loan sanction. Bankers should be able to increase the access of credit to the poor consistent with productivity without dependence on subsidy.

40. With the progressive decrease in reserve requirements from 63 per cent to 39 per cent over the last five years, the lendable resources of banks have increased from 37 per cent to 61 per cent. The base in relation to which the target of 18 per cent for agricultural lending is fixed has thus doubled apart from the normal increase in such base. In order, therefore, to achieve the 18 per cent target banks have had to more than double their lending to agriculture during a period when agricultural production itself was growing at 2.1 per cent per annum. Furthermore, the adherence to the target for agricultural lending is calculated with reference to outstandings which decrease as a result of improved recoveries and when write-offs take place. Drawing conclusions on the flow of credit to agriculture only on this basis is somewhat misleading and unrealistic. The target for agricultural lending should instead be based on the flow of credit through preparation of Special Agricultural Credit Plans (SACPs), the objective of which should be to accelerate the flow as well as to substantially improve the quality of lending. The RBI may indicate annually the expected increase in the flow of credit over

the previous year on the basis of which SACPs would be prepared. Once the system is in place the 18 per cent target would cease to have much relevance.

41. There should be a substantial modification of the Service Area Approach (SAA) so as to provide borrowers a choice of banks as well as bankers a larger area of operation. Specifically, borrowers should be free to approach any branch of a commercial bank for credit and it would be for the latter to determine whether or not to do business with the borrower. Banks should be free to operate outside their service area and the responsibility of a particular branch for the credit requirements for a specific village should continue to be made in such a manner that every village is linked to a bank branch for its credit needs. Subject to the limitation above, changes in service area where necessary should be decided through mutual consultations amongst banks at the local level and RBI approval dispensed with.

42. The agenda for discussions at the various fora created under the LBA/SAA viz. BLBC, DCC and the SLBC should be radically changed. There should be a shift from discussion on service area plans and allocation of targets to providing a forum for greater dialogue between banks and government agencies on matters concerning area development, implementation of new schemes, impact evaluation of technology absorption, identification of fresh schemes for credit dispensation, etc.

43. About 20 per cent of lands cultivated at present are by oral tenants. If such tenants are brought within the purview of the banking system, there would be overall gains in income for the tenant farmers and agricultural productivity. A review of Land Tenancy Acts may be undertaken so as to permit renting of land without the owner losing property rights.