

CREDIT TO FARMERS

1. Context and Perception

There is a perception that credit to farmers is priced higher than commensurate with the level of properly-assessed risk. This is a perception that has been articulated by the Reserve Bank also in the recent past (See Annex).

The budget measures are thus contextually relevant.

It may be noted that the main thrust of the budget announcement is to provide some relief to farmers through fiscal measures rather than cross-subsidisation within the banking sector.

2. Way forward

Reserve Bank has already commenced implementation of the relevant budget measures, while ensuring the commercial viability of banks and the overall soundness of the credit system.

The recent initiatives taken by commercial banks including in technology and processing practices are expected to increase their lending to the agricultural sector and in particular, induce pricing of credit most appropriate to the credit record at micro levels. The banks which have started assessing the commercial potential of agriculture should focus on meeting the needs of diversified agriculture and equip their branches and streamline procedures appropriately. Reorientation of skill, attitudes and systems is critical to appropriate pricing of credit. The implementation of the recommendations of the Vaidyanathan Committee (I & II) is expected to revive the rural cooperative credit structure and reduce the cost of multi-layering. At the same time, in the area of micro finance, banks are stepping up significantly their exposure to SHGs, and will also be taking increased recourse to micro finance institutions and post offices as agents to widen and deepen their outreach. Setting up of a Committee on Financial Inclusion has been announced by the Finance Minister. All these measures can be expected to lead to structural, policy, and procedural changes required to facilitate sustained delivery of financial services in the rural areas at reasonable cost.

Progress in these areas with full cooperation of the banking system should facilitate the flow of credit at reasonable terms to the farmers, paving the way for phasing out subsidisation of interest rates.

The RBI's approach to agricultural credit especially access to credit has been articulated in the various policy statements including mid term review, annual policy statements, etc. To quote :

Mid-Term Review 2003-04

Trends in the flow and composition of savings as well as availability of credit to some highly productive and socially critical sectors should be a matter of importance to all in the financial system. While credible actions, particularly by the commercial banks, would be essential, innovative measures by all concerned may have to be considered in due course if adequate progress in credit delivery accompanied by appropriate transparency in credit pricing is not observed soon. (para 52)

Annual Policy Review 2004-05

While credible actions, particularly by the commercial banks, would be essential, innovative measures by all concerned would have to be considered in due course to ensure adequate progress in credit delivery accompanied by appropriate transparency in credit pricing. (para 66)

While there is intense competition among banks to lend to large top-rated borrowers, other borrowers with long-standing relationship with banks and good credit record do not get the benefit of lower rates. It is considered desirable that banks should align the pricing of credit to assessment of credit risk so that credit delivery and credit culture is improved. (para 78)

Mid-Term Review 2005-06

With a view to ensuring financial inclusion of all segments of the population, in both rural and urban areas, a comprehensive framework to revive the cooperative credit system, revitalise the regional rural banks (RRBs) and reorient commercial banking towards the credit-disadvantaged sections of society assumes high priority. (para 57)

There is a public perception that there is underpricing of credit for corporates while there could be overpricing of lending to agriculture and small and medium enterprises. (para 61)

Some actions taken

The Reserve Bank of India has taken several actions to facilitate the stepping up of credit at reasonable interest rates to the agricultural sector and rural areas. These include :

- Revitalisation of RRBs
- Measures to improve financial inclusion in rural and under-banked areas, and
- Allowing banks to use intermediaries for providing micro savings and micro credit products.