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## Charting New Vistas

The Reserve Bank of India Act, 1934 envisaged a special developmental role for the Bank in the sphere of agricultural credit with responsibility, in particular, for financing seasonal operations and the marketing of crops. Bank finance was normally made available through eligible banks and cooperative institutions, neither of which was a major presence in the rural sector. As such the Bank itself remained a negligible source of rural credit until after independence. The pace of progress in this sphere quickened from the later 1940s. The Bank had lent a paltry Rs one lakh in the form of short-term refinancing to state cooperative banks in 1945–46. This increased rapidly to Rs 5.37 crores in 1950–51, or to about a sixth of state cooperative banks' total short-term lending to central cooperative banks.<sup>1</sup> The increase was made possible largely by the Bank adopting simpler rules and procedures for lending to cooperative credit institutions and a lower lending rate pegged at 1.5 per cent below the Bank rate. But the scope for reform on the supply side was limited so long as factors on the demand side precluded any substantial increase in the volume of Bank credit. The principal factor on the demand side was the weakness or absence of cooperative credit institutions.

The Darling Report (1935) had proposed that the Bank 'should deal only with ... provincial or central banks that are thoroughly sound ...', and observed that only three provincial cooperative banks, viz. those of Bombay, Madras, and Punjab, satisfied this criterion. Neither the situation nor the prescription had changed fifteen years later. The Rural Banking Enquiry Committee (Thakurdas Committee, 1950) stressed the importance, for an efficient system of agricultural finance, of a sound cooperative credit structure capable of developing close relations with the Bank. The informal conference hosted by the Bank in February 1951 to follow up the proposals of the Thakurdas

<sup>1</sup> In the cooperative credit pyramid, central cooperative banks functioned principally at the district level and intermediated between state cooperative banks (or apex banks) and primary agricultural credit societies.

Committee underlined that effective Bank assistance would be possible only in states where a well-knit and properly integrated structure of rural financial institutions existed, with a well-established apex institution at the helm to maintain effective liaison with the Bank and other lending institutions.

The story of the Rural Banking Enquiry Committee was recounted in the earlier volume of the Bank's history. Briefly, this committee recommended expanding the Bank's presence in all the major states including the former princely states (called Part B states), and of a reconstituted Imperial Bank of India, other commercial and cooperative banks, and postal savings institutions in the smaller towns. It proposed special efforts to strengthen cooperative institutions and extending cheap remittance facilities to rural banks and indigenous bankers in order to encourage their expansion into the interior. The committee did not investigate in any detail the institutional organization of short-term credit for cultivators. Two alternative models of organization of rural credit were canvassed in the late 1940s. While the older model stressed the role of cooperative institutions in delivering rural credit, the idea of setting up State-owned agricultural corporations for the purpose also commanded a number of adherents, especially in the former Bombay Presidency. The committee came down on the side of the former and rejected a principal role for State-owned institutions at the local level.

The Bank's preference in this regard coincided with that of the Thakurdas Committee. At the same time the Bank could not be oblivious to the fact that in 1947-48, advances and deposits of cooperative institutions were meagre, amounting respectively to Rs 1,225 and Rs 357 per society and Rs 30 and Rs 9 per member. In the circumstances the Bank felt rather more strongly than the committee, the imperative need to reorganize the cooperative structure on solid foundations.

The Bank followed up the Rural Banking Enquiry Committee with the informal conference. The conclusions of the conference too, have been summarized in the earlier volume of the Bank's history. It is sufficient to note here that following the conference's recommendation the Bank decided to organize a Rural Credit Survey and constitute a Standing Advisory Committee on Agricultural Credit. Two amendments to the Reserve Bank of India Act intended to boost the Bank's role in financing agriculture were already on the anvil in the early part of 1951. These amendments made cooperative bank paper eligible for rediscount under Section 17(2)(a) of the Bank's founding Act and increased the period of accommodation for seasonal agricultural operations and marketing of crop from nine to fifteen months. In its original form the latter amendment proposed restricting the duration of the loan to one year. But despite the Bank's reservations, the Select Committee on the bill increased it to

fifteen months to cater to the needs of growers of crops such as sugarcane. The Select Committee also added a new section to the Act authorizing the Reserve Bank to act as the banker to Part B states and an amendment empowering the Bank to call for weekly returns from all state cooperative banks.

A second set of amendments arose directly from the recommendations of the informal conference and these were passed by the legislature towards the end of 1953. These amendments widened the meaning of the terms 'seasonal agricultural operations', 'crops', and 'marketing of crops' to cover 'mixed farming' and processing of crops by farmers and their organizations, allowed advances to cooperative banks to finance the production and marketing activities of cottage and small-scale industries, and enabled medium-term lending to cooperative banks. The Bank's Central Board had rejected the first two of these three amendments as recently as 1949 when it considered the suggestions made by the Cooperative Planning Subcommittee (R.G. Saraiya subcommittee, 1945). It was a sign of the Bank's developing appreciation of rural India's credit requirements in the intervening years that it backed these reforms in 1953.

#### THE ALL-INDIA RURAL CREDIT SURVEY

The first major initiative of the Bank based on the recommendations of the informal conference was to commission a comprehensive survey of rural credit in August 1951. On the face of it, this exercise might be mistaken for a statistical investigation. The terms of reference of the expert committee (or the Committee of Direction) set up to carry it out were to 'direct the planning, organization, and supervision of the Survey', 'interpret its results', and 'make recommendations'. But as the Governor, B. Rama Rau, informed the government, the issues of concern to the inquiry were 'economic and administrative and not just statistical', and had come to the fore

directly out of the recent efforts to reorient the policies and activities of the Reserve Bank in the sphere of rural credit in response to reiterated demands in Parliament and elsewhere that a more constructive role should be adopted by the Reserve Bank in this context.

The Bank had drawn up a threefold programme, whose first two aspects (concerning 'procedural reforms' for financing cooperatives and 'organizational development and reform' of the cooperative credit structure) could be pursued simultaneously with the Reserve Bank formulating its longer-term policies on rural credit. The main task before the Rural Credit Survey was to 'recommend

practicable policies for the future'. In reality, therefore, the terms of reference of the expert committee were 'much wider than would be appropriate in connection with a merely statistical investigation'.

In the event, the All-India Rural Credit Survey was notable not only for the policies its Report recommended, but also for the wealth of the data it collected and processed. The Survey covered seventy-five districts around the country. Eight villages in each were chosen for the Survey, which was based on a sample of fifteen households from each of the selected villages. The major part of the field investigations, conducted principally by staff drawn from the cooperative and agricultural departments of the states, was completed during November 1951–July 1952. Drawing on the results of these field studies, the Survey's Committee of Direction, headed by A.D. Gorwala and comprising D.R. Gadgil, B. Venkatappiah, P.S. Narayan Prasad (who replaced B.K. Madan on the committee in October 1951), and N.S.R. Sastry drew up its Report which was submitted in August 1954. The Report filled three volumes. Of these, a two-part Survey Report contained the survey data and findings, while the Technical Report dealt with survey methodology. The General Report contained the analysis of the data and the recommendations.

The Survey found that the mechanisms of trade and finance worked against the interests of the rural population and in particular the rural producer. 'Power' and 'finance' continued to be located in largely urban areas. Credit and financial institutions tended to be oriented towards urban rather than rural needs since their executives and directors were more responsive to the former. This bias was not confined to private institutions of finance but also extended to State institutions. Both sources of finance were loosely connected.

At the far end of the chain ... are the village leaders such as *panchayatdar* and *Patel* who occupy the local seats of power, and the village financiers such as [the] moneylender and trader who are the local sources of finance. In view of their being a part of the channel of power and finance they are also recipients of power and finance from sources and reservoirs higher up the channel. Sometimes two or more of these—the village leader, the village lender and the village trader—are one and the same person and a broad affinity governs their attitudes towards the rest even where there is more than one leader ... lender ... and trader. Leadership in particular is important. It may be based on the ownership of property, on the advantage of education, on the hereditary position held in the preponderant local caste, or a combination of all or some of these factors and finally ... on political influence.

Not surprisingly hence, the Survey found 'rural credit to be an extraordinary complex of needs, purposes, fulfilments and frustrations ... surrounded and interpenetrated by many forces ... economic, sociological, institutional ....' Families covered by the Survey had, on average, a debt of Rs 160. However in nearly a third of the survey villages, average borrowing per family exceeded Rs 400, while it was below Rs 100 in 35 villages. The credit supply picture emerging from the Survey confirmed earlier impressions about the negligible presence of cooperative and other organized credit institutions in rural India. Of the total amount borrowed by cultivators in 1951-52, about 3 per cent each came from the government and cooperatives and less than one per cent from commercial banks. Non-institutional credit agencies accounted for the bulk of the lending to cultivators, with professional moneylenders contributing nearly 45 per cent of the total, and agriculturist moneylenders another quarter. According to the Report,

today agricultural credit that is supplied falls short of the right quantity, is not of the right type, does not serve the right purpose and by the criterion of need (not overlooking the criterion of creditworthiness) often fails to go to the right people.

The Survey reviewed the record of the various institutions purveying agricultural credit. Banks did not, by and large, look upon agricultural finance as part of their general business, though they did finance agriculture indirectly by lending to merchants engaged in trade in agricultural commodities. Some banks lent directly to agriculturists on the pledge of produce and valuables and on mortgage, but little had changed in the two decades since the Indian Central Banking Enquiry Committee (1931) commented on the negligible role of commercial banks, including the Imperial Bank, in making credit directly available to agriculturists. The Imperial Bank's advances for 'agricultural production' constituted a minuscule proportion of its total advances. The Report also noted that production finance for agricultural activities accounted for less than 4 per cent of commercial bank advances and credit to cultivators for less than one per cent. Even this meagre proportion was concentrated in a few districts of the country. This pattern was also reflected more generally in the poor spread of banking facilities. Moreover, since commercial banks were mainly interested in marketing agricultural produce rather than in financing production directly, their presence was largely confined to major marketing centres or *mandis*. Nor did the commercial banking system play a significant role in augmenting the resources of the cooperative credit structure. The former accounted for a mere 7 per cent of the working capital of state cooperative banks, while district cooperative

banks received only a negligible proportion of their resources by way of credit from commercial banks.

The Report also criticized the government's agricultural loans as generally being unsuited to farmers' needs. The former took the form of *taccavi* which played a useful role in times of famine and distress or in backward areas and for poor borrowers.<sup>2</sup> But in a

setting more normal as to season, area, and class of borrower ...  
*Taccavi* is apt to be little else than the ill-performed disbursement of inadequate money by an ill-suited agency.

The basis of security for *taccavi* loans was 'inappropriate', its timing was 'inconvenient', and its disbursement was subject to delays and 'impositions of various kinds on the borrower'.

Although earlier committees had reported on the small role played by cooperatives in providing rural credit, the Survey was struck by the 'utter insignificance' of these institutions. They did not cover large parts of the country and large segments of the agricultural population. A very small proportion of the credit provided by cooperatives reached medium or small cultivators who, even when they were members of cooperatives, met the bulk of their credit requirements from other sources. Socio-economic factors, principally the concentration of economic and political power in the village in the hands of a few individuals, were a formidable obstacle to cooperation. Besides the latter suffered from a dearth of suitable personnel, training, and infrastructure. Yet it was impossible to overstate the importance of rural credit cooperatives. It was almost 'axiomatic' that no form of credit organization was better suited than cooperative societies to rural requirements.

Where larger production is the aim, the moneylender's credit is ... unsuitable. The alternative is institutional credit, private or other, but this tends ... to confine itself to the bigger cultivators if it is not channelled through some form of cooperative association of the borrowers.

Consequently there was no alternative to cooperation at the rural base of the agricultural credit pyramid. Even at the higher levels 'there is eventually no alternative more suitable than a cooperative form of credit organization'. As the Report summed up the Survey's assessment and prescription, 'cooperation has failed, but cooperation must succeed'.

<sup>2</sup> *Taccavi* loans are advances to cultivators for productive purposes which are recovered along with the land revenue.

'Positive and deliberate' measures rather than 'small administrative, functional or other changes' were required to ensure the success of cooperative credit institutions and enable them to become self-supporting. The movement had to be strengthened against competition and opposition from private trade and other private interests. As importantly it had to be protected from their embrace:

... private banking and private trade, particularly at the village level, have a vested interest in the failure of cooperative credit. This is less ... strong and more implicit ... at the higher levels but stronger and more explicit at the lower stages. When a local cooperative gets into the charge of a village moneylender, and more especially the landlord-moneylender, he becomes the society, the depositor and the borrower, all of them together or each in turn ....

Besides it was also necessary to equip cooperatives with finance and modern business techniques.

Only the State, the Report argued, could provide the requisite initial help in each of these respects. Indeed, for many societies, State participation might make the difference between viability and collapse. Therefore, partnership with the State, which was also expected to participate in the share capital of cooperative credit societies, was a key element in the Rural Credit Survey's recommendations. Bringing in the State necessitated changes to the dominant pattern of organization of primary cooperative societies, which could not expect to attract government contributions to share capital if they continued to be registered as unlimited liability units or restricted their membership to a chosen few. The Report also envisaged that in order to be viable under Indian conditions, primary societies would have to be fairly large, and cover a number of villages.

The Rural Credit Survey pointed out that the State's role would become even more significant and wider-ranging if cooperative credit was viewed merely as one aspect of wider cooperative rural economic activity involving food processing, warehousing, and marketing. The State's tendency in the past had been to 'over-administer and under-finance' the cooperative movement, but this had now to yield to a 'total programme ... of rural orientation of the operative forces of the country's administrative and financial organization' motivated by a 'combination of rural conscience, rural will, and rural direction'. Moreover, since cooperative credit institutions depended on the banking system for a number of services, there was 'need for positive State association with a defined sector of commercial banking'. To this end,

the Report recommended the creation of the State Bank of India, through the statutory amalgamation of the Imperial Bank of India and the major state-associated banks, to undertake an expeditious programme of banking expansion particularly in the rural areas. The Reserve Bank was expected to manage the Imperial Bank's passage to State ownership, hold a portion of the equity of the new bank, and employ it in agency roles at centres where the Bank was not represented.

The Report devoted a separate chapter to the Bank's role in the proposed integrated system of cooperation and rural credit. This role was 'of crucial importance' and represented 'a natural and logical evolution' of the Bank's responsibilities such as would add to its 'strength, soundness and ability in the discharge of its wider functions as the Central Bank of the country'. The Report envisaged a key role for the Bank in coordinating the proposed network of cooperative institutions and for its Agricultural Credit Department in overseeing their functioning. The Bank would occupy a 'strategic position' in the cooperative credit sector, while in the other two sectors of the proposed integrated system of rural cooperation, viz. cooperative economic activity and the training of cooperative personnel, it would be 'among the principal participants'. The Report approvingly quoted the Bank's recognition that it could not turn to 'central banking practices evolved in the highly industrialized countries of Western Europe' for guidance to finance rural India's credit requirements. In enlarging its development functions as the Report recommended, the Bank would be

further departing from the orthodox pattern of central banking in other and differently situated countries, [but] it will at the same time be approaching nearer what the central bank of *this* country ought to be.

The Survey Report also made a number of recommendations concerning long-term finance for agricultural development. Finding the latter virtually non-existent in India outside the erstwhile Madras Presidency, the committee recommended the establishment of a central land mortgage bank in each state with branches in each district. Compact and cohesive yet viable, primary banks were to follow after the other two tiers of the structure had found their feet. The existing system of land mortgage banking, the committee felt,

raises inadequate funds in a manner ill-related to demand and usually lends them in a manner uncoordinated with development; acts as if prior debts, and not production, had prior claim on its attention; reaches mainly the large cultivator and reaches him late.



This, the Report stressed, had to be replaced with a motivated lending policy which emphasized loans for productive purposes such as land improvement and purchase of machinery. In keeping with the need for loans for varying periods, the Report recommended that central land mortgage banks should be encouraged to float debentures and that the Reserve Bank and the proposed State Bank of India should take positive steps to create an effective market for them. The Report also suggested the issue of special development debentures to finance specific programmes of land improvement, and of rural debentures to tap the savings of rural households. Finally, the committee recommended a number of measures which the state governments could take in the administrative, fiscal, and legislative spheres to facilitate the creation and functioning of long-term lending institutions in agriculture.

The Rural Credit Survey recommended the establishment of a National Agricultural Credit (Long-term Operations) Fund and a National Agricultural Credit (Stabilization) Fund from which to meet the liabilities arising from the Bank's new functions. Apart from an initial non-recurring contribution of Rs 5 crores, the Bank was to contribute at least Rs 5 crores to the former fund and Rs one crore to the latter fund annually from its profits. The Operations Fund was intended to finance long-term lending to state governments to enable them to subscribe, whether directly or indirectly, to the share capital of all types of cooperative credit institutions, and enable the Bank to assist land mortgage banks through direct loans and the purchase of their 'special development debentures'. The Stabilization Fund was intended mainly as a source of medium-term finance for cooperatives to help them convert short-term loans which had gone into default due to natural factors like drought. The Bank's expanded rural credit responsibilities were to be overseen by two committees. The smaller of these was to be confined to the Bank and entrusted with overseeing the implementation of its rural credit programmes. The larger committee was envisaged as an expert policy-review body that would bring together the Bank, the Government of India, and the proposed National Cooperative Development and Warehousing Board.

The Report also proposed the establishment of other dedicated funds such as the National Agricultural Credit (Relief and Guarantee) Fund under the Ministry of Food and Agriculture, a National Cooperative Development Fund and a National Warehousing Development Fund under the National Cooperative Development and Warehousing Board, an Integration and Development Fund under the State Bank of India, a State Agricultural Credit (Relief and Guarantee) Fund and a State Cooperative Development Fund under each state government, and finally Agricultural Credit Stabilization Funds corresponding to each level of the cooperative pyramid. Apart from the State Bank of India and the

National Cooperative Development and Warehousing Board, the Report also proposed an All-India Warehousing Corporation and similar organizations in the states.

The agenda for action and institution-building proposed by the All-India Rural Credit Survey was by almost any reckoning, impressive in scope and ambition. The widespread reaction it evoked in the press and elsewhere also attests to the considerable impact of the Survey Committee's Report. Equally noteworthy was the despatch with which the Bank and the government moved to implement its principal recommendations. The Report of the Rural Credit Survey was submitted in August 1954 and published in December the same year. By February 1955 the basic features of the new cooperative infrastructure had been agreed upon and action initiated to carry out the legislative and other changes needed to set it up. Intensive consultations followed at various levels to discuss and approve the main recommendations of the Rural Credit Survey Committee, while most of the proposed legislative changes went on the statute book by the end of April 1955. By May or June 1955 therefore, the decks were cleared for the inauguration of the programme of cooperative development envisaged by the Rural Credit Survey Committee.

To judge from the press coverage, the wider public reaction to the Report was largely positive, even in some cases eulogistic. *The Times of India* for example hailed the Report as a 'monumental effort' which filled a 'major void in the Indian economic picture'. The *Economic Weekly* remarked that the Report had dealt 'very commendably' with the 'rural problem as a problem not only of economic arrangements directed to several worthwhile ends, but also of social adjustments, leadership, and psychological orientation'. Malcolm Darling, who was probably the foremost authority on agricultural cooperation and credit in the colonial government and whose recommendations had provided a framework of organization and activity for the Bank's Agricultural Credit Department, welcomed the 'wide sweep' of the Survey, 'its wealth of illustration, the gradual building up of its proposals, and [their] firm cementing together ....' He commended the 'remarkable Report' to 'all countries wrestling with the problem of increasing production in order to satisfy a rapidly increasing population'.

Inevitably, there was some criticism focusing mainly on the role envisaged for the government in the cooperative sector and the committee's plans for the Imperial Bank. *Indian Finance* presented a positive appraisal of the Report but remarked on the committee's 'awkward brand of eclecticism'—'in the temple proposed to be erected for cooperatives, the deity to be installed is the Government'—and believed the committee was unrealistic in expecting the

State's 'dominance' to be temporary. *The Hindu's* disagreement with the Report was more fundamental. Observing that according to the Survey, nearly three-quarters of rural credit needs were met by private lenders, it said the committee should have formulated its policy to accord with this reality. Instead

it has plumped for a strengthening of the cooperative credit organization to be reinforced by a ... Reserve Bank-cum-State operated bank formed by the amalgamation of the Imperial Bank and ten State Banks. The Committee's unlimited faith in the virtues of State control is only equalled by its ill-conceived distrust of the individual—whether he is a moneylender, trader, or even an agriculturist ....

Although the cooperative movement had by the committee's own admission failed in spite of a half century of government support, its solution is 'more Government control and more State-sponsored Cooperation'.

Some cooperators too opposed the Report of the Rural Credit Survey, notably for proposing State partnership in primary societies. As we observe below, the principal orthodox arguments against its recommendations also cropped up in internal Bank discussions of the Report and at meetings of the Standing Advisory Committee on Agricultural Credit. But in attacking the Rural Credit Survey's findings, orthodox cooperators offered few positive suggestions or alternatives. Besides, many critics of the Rural Credit Survey opposed State *partnership*, but not State funding if it came without any supervision. Appeals to 'fundamental principles of cooperation' or to the necessity for 'democratic give-and-take' between the State and cooperative societies and for 'aid without strings' did little to mask the fact that few in the Indian cooperative movement were sufficiently alive to the hazards of freely entrusting large public funds to private bodies even if these be cooperatives. Nor were critics of the Bank's approach willing altogether, to abandon the principle of exclusivity (of membership) to qualify for public funds. For example, they generally regarded small farmers in need of rehabilitation as 'primarily the duty and responsibility of the State'. The cooperative movement could not, according to them, be expected to undertake 'a programme of rehabilitation' since the latter was not a 'foolproof banking proposition'.

#### *The Bank's Reaction to the Report*

In contrast to the energy and purpose which came later to mark its pursuit of the policies recommended by the Rural Credit Survey, the Bank's initial

response to the latter's Report was cautious and uncertain. The Agricultural Credit Department which was soon to expand into the nodal agency for rural credit, was initially quite sceptical about several of the Committee's recommendations. It is useful to summarize the department's reservations here, since it helps to illustrate the intellectual distance the Bank and its rural credit officers travelled to keep pace with society's changing expectations from the cooperative sector. Although some orthodox cooperators distrusted the Agricultural Credit Department and campaigned to transfer its functions to a variety of bodies outside the Bank, it is worth noting that within the Bank, this department echoed some of their criticisms of the Committee's proposals for cooperative reform. These and similar criticisms returned to haunt the Bank a few years later and led to growing differences with the government over the organizing principles of the cooperative credit movement.

The views of the Agricultural Credit Department were largely formed at this time by its Chief Officer, J.C. Ryan. He was brought into the Bank in 1954 on deputation from Madras state where he was the Registrar of Cooperative Societies, to strengthen and equip the Agricultural Credit Department for the formidable new responsibilities that lay ahead. Ryan retired from the Madras government in 1955 and remained the Chief Officer of the Agricultural Credit Department until 1960. He was, in many respects, a larger than life presence in the rapidly expanding department, whose stamp is clearly discernible at all levels of its functioning. But schooled in the orthodox tradition of cooperation practised not without some success in Madras, Ryan's initial response to the Report of the Rural Credit Survey was one of scepticism. He challenged the Report's emphasis on the State subscribing to the share capital of primary societies. State participation was not necessary to enhance the borrowing limits of most societies since they were constituted on the basis of unlimited liability, and their credit limits fixed in relation to members' net assets. It was of dubious benefit to societies founded on limited liability. More fundamentally, the Report's stress on the size of a society's owned capital, Ryan argued, risked introducing principles of joint-stock banking into the cooperative sector. The former represented a 'union of capitals'. It was an 'association of lenders' which lent chiefly to those outside itself. Primary societies were, in contrast, 'unions of individuals', or 'associations of borrowers who lent only to themselves'. Reiterating fundamental principles of cooperation which he felt had been ignored by the Rural Credit Survey's Report, Ryan's note remarked that cooperative credit societies 'capitalized honesty' and borrowed on the strength of the thrift of their members. Their activities were of an 'educative character' and were always informed by the principle of self-help.

If facilities for borrowing are provided by increasing the share capital of primary societies with State subscriptions this educative character will gradually disappear. There will be less desire to save and rely on oneself and an increasing tendency to depend on the State. While it is certainly necessary to extend rural credit, it is more important that the agricultural-borrower should be educated in self-help and thrift.

Ryan also feared that the proposed Stabilization Fund would weaken the cooperative movement by making the borrower 'less responsible than he should be'. Such a fund may make lenders too less responsible, and increase the risks of loans being given without adequate scrutiny, or of bad debts being written off without much effort to recover them. Thanks to such hazards, he pointed out, the Government of Madras had been forced to scrap the Revolving Fund which it had earlier set up to relieve distress caused to borrowers by famine. In any case, he contended, the Stabilization Fund should not be entrusted to cooperative central banks whose 'managements ... are in increasing measure in the hands of borrowers' representatives', but to an 'independent agency unconnected with the cooperative movement', such as the Judiciary or the Revenue Department, or a Credit Stabilization Board set up by the State under a special statute. The separation of roles would, in the officer's view, leave central cooperative banks 'intact as business institutions and avoid producing the impression that they are also agencies for relieving distress'.

The Report's plan for large primary credit societies covering many villages also came in for criticism. It went against the thrust of national development plans organized around the village as the unit. More importantly, large societies were unlikely to benefit small cultivators and tenants. The sustained expansion of rural credit depended not on lending against property, but lending against a borrower's character. The possibility of capitalizing such non-tangible assets constituted the essential advantage of a cooperative form of credit organization over one based on joint-stock banking principles. The Report also recognized the necessity for primary societies' lending operations being informed by criteria such as the borrower's character and honesty. But according to Ryan, its proposal for large societies undermined this emphasis, since it would be difficult to assess the character of intending borrowers if they were spread over a large area covering several villages. Once the principle of 'proximity' was violated, the small borrower would cease to get credit on reasonable terms, and societies would, in effect, confine themselves to lending on the pledge of movable and immovable properties, thereby defeating the very objects which the Report hoped to promote.

Ryan also objected to the structure of organization of rural credit institutions proposed by the Committee. The proposal for cooperative and land mortgage banks at the higher levels of the rural credit structure acquiring shares in institutions at the lower level was unsound, as it involved the 'creditor (becoming) a partner in the affairs of the borrower'. This model of ownership was particularly inappropriate in the centralized land mortgage banking structure where money raised by the centre was passed on to the units, who themselves had no responsibility for raising any funds.

The Report's recommendation that membership of primary credit societies should be open to all persons residing in the areas they covered, and that anyone refused admission should have a right of appeal to the Registrar of Cooperative Societies, also did not, according to Ryan, accord with the voluntary basis of cooperation. Though emanating in the desire to make credit available to every creditworthy borrower, this recommendation, Ryan felt, treated agricultural credit societies as public bodies and violated their autonomous powers, particularly in relation to how they constituted themselves.

An agricultural cooperative credit society is not a public institution like a village panchayat or a municipality, where residence for a prescribed period ... entitles one to vote. It is a private body like a Cricket Club or the Cosmopolitan Club ... brought into existence by a group of individuals getting together on a voluntary basis .... These individuals have a right to say which one of their fellow villagers can be permitted to associate with them and which should be kept out, in the same way as the Cosmopolitan Club can blackball any applicant for membership without assigning any reason.

The right to exclude persons judged to be unsuitable was particularly important in the case of unlimited liability societies where bad members might put at risk the 'worldly belongings' of other members of the society. It could not be denied even to limited liability societies, since defaults by a few borrowers could lead to the other members of a society losing their share capital contributions.

Ryan's views did not in the event, carry the day. As noted above, similar views had been aired on earlier occasions and considered by the Rural Credit Survey Committee, so that they did little to arrest the momentum generated by the Report. At other levels of the Bank too, some recommendations of the Rural Credit Survey did not command immediate acceptance. According to the Deputy Governor, N. Sundareshan, Governor Rama Rau held 'certain strong views' on the need for the funds proposed by the Committee. The Governor

himself confessed that while he had no 'strong objections' to the proposed funds, he was not convinced of their necessity and that he favoured suspending the Bank's internal exercises to determine how it could finance contributions to them.

While some aspects of detail in the Survey's proposals for the rural credit structure were no doubt debated, there was in general an impressive consensus on the broad thrust of the Report—that the asymmetry between the tasks facing the cooperative movement and its coverage and resources could not be redressed unless the State was drawn into partnership with it and that this partnership necessitated some departures, none altogether novel or untested, from certain orthodox conceptions of cooperation—and its principal recommendations. The Credit Survey's Report was still in draft form when a rough programme of action was devised first to consider the Report's recommendations, and then to pave the way for their implementation. The Finance Ministry, and in particular the Finance Minister, C.D. Deshmukh, too was anxious that decisions and legislative amendments necessitated by the main recommendations of the Report should be adopted with the least delay, so that action on the Credit Survey's Report was set in train almost immediately after it was submitted.

Towards the end of 1953, the Bank and the government jointly established the Central Committee for Cooperative Training to organize and direct the development of manpower for the cooperative sector. This Committee and the Bank's Standing Advisory Committee on Agricultural Credit met jointly in January 1955 to consider the Report of the All-India Rural Credit Survey. This meeting was also attended by senior officials of the Government of India from Finance, Food and Agriculture, and the Planning Commission. It is useful briefly to summarize the proceedings of this meeting, since some of the points raised there resonated in some form or other through the cooperative movement and official policy for much of the next decade.

There was some criticism at the meeting, for example by M.B. Nanavati, distinguished cooperator and former Deputy Governor of the Bank, of the Committee's Report focusing too closely on rural credit for productive needs, and not enough on the cultivator's need for consumption loans and other areas of activity where the cooperative presence would prove useful. Cooperation, Nanavati felt, should deal with the 'whole man', and he implied that this perspective was lacking in the Report. Tarlok Singh, Joint Secretary at the Planning Commission, also felt that the Report had treated areas of cooperation other than credit 'somewhat broadly'. At the Governor's invitation, J.C. Ryan criticized the Report from the standpoint of 'orthodox principles of cooperation', while D.G. Karve defended the departures the Report made

from them on the ground that cooperatives could no longer afford to be 'exclusive clubs', and that they should become 'all-embracing'. The idea of a cooperative as a 'closed shop' was also rejected by M.R. Bhide, Joint Secretary in the Ministry of Food and Agriculture.

It was however the principle of State partnership that evoked the most comment at this meeting. A number of cooperators welcomed State participation in the equity of cooperatives, though they wanted the principle to be applied flexibly. Some cooperatives, they emphasized, might opt not to invite the State while others might not be viable without it. There was near unanimity among those who welcomed State participation that the latter should not overwhelm a cooperative of which it was a member, either through its voting strength or through its bureaucracy. The principle of State participation was however contested both by Bhide and more indirectly by Tarlok Singh. Defending the Report, D.R. Gadgil pointed out that rural credit, and not cooperation, formed the substance of the Committee's brief. The Committee had dealt with cooperation only because it felt this to be the most suitable agency for supplying agricultural credit. But it had refrained from covering the subject in all its aspects for fear of straying too far from its brief. He pointed out that state financial corporations could be regarded as an alternative to cooperatives. When earlier committees proposed the former course, cooperators were forced to choose between 'acting as closed associations cherishing certain spiritual values or functioning as agencies of State policy embracing all creditworthy agriculturists'. Implying that the State could not be expected to leave the field open to 'closed shop' cooperatives, much less associate with them legitimately, he pointed out that if cooperators

could not accept the type of Cooperation envisaged, then, the State would have to think of alternative arrangements to implement its policies. The last word on this subject rested with the State and the people and not with cooperators alone.

Summing up the discussion, the Governor, who was also the Chairman of the two committees, noted that it would be inappropriate to expect the pattern of cooperation to be uniform across the length and breadth of the country. While there was general agreement on the principle of State partnership, the extent of this would depend, he stressed, on the 'requirements of each area'. The joint meeting then endorsed the broad thrust of the Report of the All-India Rural Credit Survey, and underscored the importance of coordinating the reorganization of rural credit with planned agricultural development, growth of marketing and processing facilities, and of cottage and other rural industries. The committees were both of the view that the object of credit reform in the



agricultural sector should not only be to increase the availability of institutional credit, particularly to small and medium cultivators, but also to link its use effectively to production.

These views set the tone of much of the rest of the deliberations on the Report at the other levels of decision-making in the Bank. Within a few days of the joint meeting, the Bank's Central Board also backed the Survey Committee's Report. Apart from the proposal to establish the State Bank of India, the Board too paid particularly close attention to the Committee's recommendation to reorganize cooperative credit and economic activity on the basis of State partnership. The Governor's report to the Board echoed the earlier discussions in the Standing Advisory Committee, but he also went beyond it to defend the principle of State partnership. The Report, the Governor affirmed, had ended the extended debate between proponents of State assistance to agriculture and those who took the orthodox line that cooperation should be independent of all State influence and assistance. Indeed, the kind of partnership between the State and the cooperative movement outlined by the Survey Committee was not novel, being already in vogue in several states. The total contribution of state governments to the share capital of various apex cooperative institutions exceeded half their paid-up capital, and all the Report recommended was to generalize the principle rather more widely. Finally, the Governor supported the Committee's expanded conception of the role of the Reserve Bank in an undeveloped country. The Bank had inevitably to take on a major developmental responsibility in the sphere of agricultural credit which, he stressed, could be more effectively discharged in partnership with the cooperative movement than through new corporations.

The Government of India was also engaged in considering the Report at almost the same time as the Bank. The most immediate decision confronting the government related to the future of the Imperial Bank of India. For reasons discussed elsewhere, the Bank and the Government thought it prudent to announce the decision to nationalize the Imperial Bank of India and reconstitute it as the State Bank of India at the same time as the Report was released. The government's response to the other recommendations of the Report was considered at the secretariat level by an inter-ministerial committee comprising representatives of the Planning Commission, the Food and Agriculture Ministry, and the Ministry of Finance. There was, inevitably, some difference of opinion within the government on some important aspects of the Report. For instance, both the Food and Agriculture Ministry and the Planning Commission were opposed to the State participating in the capital of primary societies as it 'may well injure the development of the National Extension and community development programme'. The Report's proposals for developing

warehousing and marketing in the cooperative sector were also not to the satisfaction of the Commission. But as the Cabinet memorandum on the Rural Credit Survey Report noted, there was general acceptance of its recommendations and of the 'responsibilities devolving in this behalf on the Central Government', particularly those for wider planning, coordination, and financing of cooperative activities. The Cabinet memorandum remarked that the problem of rural credit had been investigated by many committees and commissions, and several proposals aired in its connection. The Rural Credit Survey Committee had, however, made the most detailed and authoritative study of the problem. It had had

the benefit of a countrywide sample survey investigation and in their recommendations have laid under tribute along with the results of the survey all the extant material on the subject including reforms suggested from time to time. [The Committee have] propounded a fully worked out and comprehensive solution of the problem of rural credit. In this much-canvassed subject, it would seem best for early and effective action that the solution as evolved by the committee is taken as the basis of discussion.

Viewing the Report in the background of the country's development plans, the Cabinet memorandum noted that the ambitious scheme for cooperation proposed by the Survey would have to be phased in over several years. The problem of credit could not, moreover, be solved by a reform of the credit mechanism alone but only as part of a general programme of agricultural reorganization. Hence it would be necessary to ensure that cooperative schemes sponsored under the proposed programme were coordinated with other developmental activities in the Community Project and National Extension Services Block areas where they should first be implemented. Since responsibility for agriculture and rural credit rested with the states, the memorandum proposed convening a conference of ministers of state governments concerned with cooperation to discuss the Report's recommendations. While deferring the adoption of a detailed plan of action, the Cabinet memorandum generally endorsed the Report's proposals for the development of cooperative marketing and warehousing, and those for the establishment of funds under the Ministry of Food and Agriculture. However, the memorandum argued that the object of the Relief and Guarantee Fund might be better met through an undertaking on the part of the centre to support state governments whenever their own Credit Stabilization Funds were strained beyond capacity.

The liability which this fund is concerned with is a highly contingent liability, and it can therefore be argued that it may more appropriately be met out of the current resources of the Union Government.

It is worth noting, in passing, that the idea of a central relief fund was also put forward by the cooperative development subcommittee constituted in connection with the preparation of the second five-year plan, and although the Bank returned to the charge on the basis of this document, the Centre remained unshaken in its view that such a fund was superfluous.

The Indian Cooperative Congress met in Patna in March 1955 to discuss the recommendations of the Survey Committee. The Congress accepted the recommendations, including those pertaining to State partnership, in principle, but suggested that in order to preserve the autonomy of cooperative institutions, government nominees to the boards of State-supported institutions should not exceed three in number and that they should as far as possible be experts and persons of special cooperative experience rather than government officials.

The Ministry of Food and Agriculture also convened a special conference of state ministers of cooperation in New Delhi on 16 April 1955 to consider the Survey Committee's proposals. In his speech to the assembled ministers, the Union Food and Agriculture Minister, Ajit Prasad Jain, declared that the Rural Credit Survey Committee had produced a 'monumental document' which contained 'one of the most comprehensive' analyses of 'rural credit and connected problems', and 'a practical scheme for [the] development and reorientation' of the cooperative movement. He praised the Reserve Bank for playing an 'ever-increasing role in organizing rural credit'. Citing expert opinion, he said the Bank had given

a new life and potent leadership to the cooperative credit movement in recent years. Probably, no other central bank in the world is doing as much to help develop and finance cooperative rural credit institutions. This ... novel feature of the Reserve Bank ... has no parallel in the banking system of the highly industrialized countries of the West.

The conference also approved the principle of State partnership and the proposed integrated scheme of rural credit. It however cautioned that State participation should not become a pretext to dilute the popular character of cooperative institutions or undermine the initiative and responsibility of their members. The ministers also set targets for 1960–61 that envisaged the trebling of the membership of primary agricultural societies from the existing base of

five million members, a fivefold increase in short-term and medium-term loans which stood at Rs 30 crores and Rs 10 crores respectively, and an increase in long-term loans from Rs 3 crores currently to Rs 25 crores in 1960–61. However in order to avoid overextending financial and organizational resources, the conference decided to initiate the integrated scheme for rural cooperation on a pilot basis in two or three districts in each state during the next two years, using the resources available in the first plan.

The speed with which the Report's findings were endorsed and acted upon suggested, according to its critics, a 'measure of predisposition'. Even if the Bank was so predisposed, this explanation fails to account for the promptness with which the government and legislative bodies proceeded to clear the decks for implementation. Legislation to enable the Bank to carry out the responsibilities entrusted to it under the new arrangements was the next step, and this was carried out with the utmost despatch. The Bank prepared a draft bill which, among other things, authorized it to make long-term loans to state governments to subscribe to the share capital of cooperative institutions and to central land mortgage banks, and set up the proposed special funds. At the same time the existing statutory limit of Rs 5 crores on medium-term loans was removed. The bill also provided for a third Deputy Governor who, it was intended, would have exclusive responsibility for rural credit. The Bank's Central Board approved the bill towards the end of February 1955. The Bank was keen to have the necessary legislation passed in the budget session of Parliament, and progress thereafter was swift. The government accepted the bill within weeks. Introduced in the Lok Sabha on 26 April 1955, it was adopted by both houses on 29 April and passed into law on 8 May 1955.

Debate on the bill focused, expectedly, on the question of expanding rural credit. Introducing the bill, the Minister of Revenue and Defence Expenditure, A.C. Guha, affirmed that in spite of the weaknesses of the cooperative movement, neither the Bank nor the government had lost faith in it, and that both were committed to making cooperative organizations the principal channel for rural credit. Commenting on the growing role of the Bank in the sphere of rural credit, he stated that the binding constraint on the availability of resources was the capacity of the cooperative structure to utilize them effectively. The Bank's initial contribution to the Long-term Operations Fund had already been raised to Rs 10 crores from the Rs 5 crores proposed in the Survey Report, and more funds would be made available as necessary. Responding to the criticism of members that the amounts involved were inadequate, the minister argued that it was 'no use putting [in] a bigger sum unless we can set up the appropriate machinery to utilize' it. The minister also defended the Bank against criticism that its inspection procedures were intrusive, and

emphasized that even though cooperation was a state subject, cooperative organizations voluntarily subjected themselves to Bank inspection and offered its inspectors every assistance in discharging their duties.

Legislation to set up the National Cooperative Development and Warehousing Board and the Central Warehousing Corporation was passed in 1956, the former coming into existence in September 1956, and the latter in March 1957. The following years also saw the establishment of warehousing corporations in most states.

The newly created post of Deputy Governor was filled fittingly by the elevation of B. Venkatappiah who, along with Gorwala, played a key role in formulating the Rural Credit Survey's recommendations and then following them up both within the Bank and outside. Venkatappiah's assumption of the new position in July 1955 marked a new phase in the expansion and development of the Bank's Agricultural Credit Department, which soon established a presence in every state of the Union. Finally, while the Rural Credit Survey's suggestion to constitute an advisory council comprising representatives from the states, economists, cooperators, and other experts was not adopted because it would duplicate other existing expert bodies, the Bank felt the need to reconstitute its Standing Advisory Committee on Agricultural Credit so as to make it an expert, rather than merely a representative, body.

It is helpful to distinguish the three spheres in which the Bank initiated and coordinated action in direct consequence of the recommendations of the Rural Credit Survey Committee. These were (i) the nationalization of the Imperial Bank of India and the banks associated with the former princely states, (ii) restructuring the short-term cooperative credit structure, and (iii) reorganizing the institutions specializing in longer-term lending for agricultural development. The creation of the State Bank of India and the Bank's efforts to develop a viable short-term cooperative credit structure are discussed in the chapters which follow. The remainder of this chapter deals with the Bank's evolving policies towards medium-term lending to agriculture, and with its efforts which culminated in the creation of the Agricultural Refinancing Corporation of India, to support and finance an effective mechanism for purveying longer-term agricultural loans.

### MEDIUM-TERM LENDING FOR AGRICULTURE

Until 1953, the Reserve Bank of India was not allowed to grant medium-term loans. An amendment to section 17 of its Act enabled the Bank to grant such loans for agricultural purposes, subject to an overall ceiling of Rs 5 crores.

The creation of the National Agricultural Credit (Long-term Operations) Fund in 1955 helped relax this ceiling. In 1956 the Bank was authorized to specify from time to time the purposes for which it would make medium-term loans. Over the years such loans were made to finance a wide range of investments, including land reclamation, bunding and other land improvements, preparation of land for orchards, purchases of livestock and agricultural machinery, construction of farmhouses, and acquisition of shares in cooperative sugar factories. In 1967, this list was expanded to include sinking of wells and installation of pump-sets. The Bank extended medium-term assistance to land mortgage banks on the guarantee of state governments. In the beginning, land mortgage banks made loans only on the mortgage of land, but this stipulation was eased in 1959–60. The period of a medium-term loan was also originally restricted to three years. The limit was raised to five years in 1956, but a state cooperative bank was allowed to use only a quarter of the funds it drew from the Bank to lend for the longer period. Until 1960 the Bank charged state cooperative banks the same concessional interest rate on medium-term loans as it did on short-term loans for seasonal agricultural operations, i.e. 2 per cent below the Bank rate. The ultimate borrower was charged 6.25 per cent per annum.

In 1959 the Bank conducted a rapid survey of medium-term agricultural lending throughout the country to ascertain the adequacy of loan supervision. Operational matters such as fixing credit limits, the rate of interest, and the nature of security were also to be reviewed in the light of this survey which revealed that utilization of loans was far from satisfactory. Nor was the monitoring of loan use effective: cooperative banks were concerned mainly to secure their loans, and did not pay much attention to the purposes for which the latter were taken. 'Chattel' was a complicated form of security in India since the term was not defined in Indian law. There were also problems in identifying chattels such as cattle and in providing for their insurance and maintenance. Partly to moderate the extent to which security dominated 'purpose' in the priorities of cooperative medium-term lending institutions, in September 1960 the Standing Advisory Committee recommended waiving the requirement for mortgage of land on small medium-term loans up to Rs 500. It also recommended fixing the rate of interest on the Bank's medium-term loans at half per cent above that on its short-term loans. This increase was partly intended to discourage cooperative banks from using the Bank's medium-term funds to extend short-term loans.

Earlier the Bank was of the view that it could only be a source of supplementary medium-term assistance to cooperative institutions. However after 1962, the Bank consented to refinance up to three-quarters of the medium-

term loans that apex and central cooperative institutions made over and above a 'basic level' of lending. This level was defined as the volume of medium-term loans made by these institutions out of their own resources at the end of June 1962. Experience showed that, either because they could not maintain their lending at or above the 'basic' level or the time-lag involved in drawing funds from the Bank was too long, central cooperative banks were reluctant to make medium-term loans and often did not utilize their limits in full. As discussed later, the time-lag problem also rose in a different form in the case of land mortgage banks making long-term loans to agriculture. The question of liberalizing the Bank's refinancing norms first arose in 1962 and then again in 1967. On the latter occasion, the Government of India wanted central cooperative banks to be set a maximum 'basic' level of Rs 10 lakhs. Besides, it suggested allowing banks with audit ratings 'A' and 'B' to draw advances of up to half their owned funds, subject to a ceiling of Rs 15 lakhs. These advances were proposed to be set off against limits sanctioned by the Bank. Faced with such requests, the Bank generally refused to yield on the principle that it would only reimburse loans already made by the disbursing agencies and that it would not advance interim or provisional medium-term (or for that matter long-term) credit. However, it agreed progressively to relax its refinancing norms. In 1963 the margin contribution of state and central cooperative banks to a medium-term loan had already been reduced to 10 per cent from the 25 per cent prevailing until then, while in 1967 the Bank agreed to lower as circumstances warranted, the threshold or 'basic' level of medium-term lending that qualified a cooperative financing agency for access to the Bank. Such adjustments, in the Reserve Bank's view, were superior to the alternative of forsaking its role as a *refinancing* agency and contributing to the working capital of cooperative financing institutions.

By the mid-1960s, the Bank was forced to rationalize its policy and procedure on medium-term lending. The object of the exercise was to optimize the utilization of available medium-term resources and to ensure that medium-term loans were clearly demarcated from short- and long-term loans. The new medium-term loan policy adopted in April 1965 counselled lenders to extend long-term loans whenever a borrower required more than five years to repay the loan. It sought to further mitigate the emphasis on security and the tendency to disregard the purpose for which a loan was sought, by relating loans to the project's outlay estimated on the basis of standard unit costs, and the borrower's capacity to repay. As another step towards reducing the importance of property as a qualification for credit to finance new investments, the income expected to be generated by the project financed by the loan was also to be taken into account wherever that could be reliably assessed.

## REORGANIZING LAND MORTGAGE BANKING

Having come into existence in the depressed 1930s mainly in order to reduce the farmer's burden of debt, land mortgage banks made loans in their early years largely for the redemption of prior debts and mortgages on land. The challenge facing the Bank and the state governments in the 1950s was to transform the existing system of land mortgage banking into a more dynamic instrument of financing longer-term productive investment in agriculture.

Land mortgage banks were spread unevenly across the country. More than half the states of the Union did not have a single land mortgage bank in 1951, while only five states, viz. Madras, Bombay, Orissa, Mysore, and Travancore-Cochin, boasted central (i.e. in this case, state-level) land mortgage banks. In one state, Madhya Pradesh, land mortgage banking was carried on by a separate department of the state cooperative bank. Following the passage of the Saurashtra Land Reforms Act in 1951, a central land mortgage bank was set up in the state with the immediate objective of enabling tenants to acquire occupancy rights. During the next few years, a number of other central land mortgage banks were established, so that there were eighteen such banks by the middle of the second five-year plan.

There were 286 primary land development banks at the end of 1950–51. Sixteen primary land mortgage banks were organized during the first plan, and this number rose steadily to 161 and 210 in the next two plans, and by June 1967 a total of 707 primary land mortgage banks were in existence. Nearly 450 of these were, however, in the areas covered by the three southern states of Andhra Pradesh, Madras, and Mysore where land mortgage banking had begun making notable strides in the 1930s.

The structure of rural long-term lending institutions was not uniform across the country. In some states, it was federal in nature, with primary land mortgage banks affiliated to the central land mortgage bank. In other states, particularly where the system was still in its infancy, the structure was more unitary, with the central land mortgage bank also functioning at the local level through its branches. A number of expert committees recommended a federal structure for the land mortgage banking system. Primary land mortgage banks were thought to allow greater play than the branch of a central bank for local initiative, promote better monitoring and recovery of loans, and help popularize instruments for mobilizing agricultural savings such as rural debentures. But the land mortgage structure remained unitary and centralized in a number of states until the end of the period covered by this volume, and the All-India Rural Credit Review Committee (1969) had once again to underscore the advantages of a decentralized 'long-term cooperative credit structure'. The



reach of the land mortgage banking system also varied across states. As late as 1967–68, primary banks or branches of the central bank existed at the taluk or subdivisional level only in Andhra Pradesh, Gujarat, Maharashtra, Mysore, and Madras. In most other states, these institutions were confined to district or divisional centres.

In order to strengthen central land mortgage banks financially, state governments were encouraged to subscribe to their share capital. The Bank financed these subscriptions to a significant extent out of the National Agricultural Credit (Long-term Operations) Fund which was set up in 1955–56, and which had accumulated resources of Rs 20 crores at the end of the following year. By 1967–68, state governments had contributed Rs 6.67 crores to the share capital of central land mortgage banks, or about 27 per cent of their total paid-up capital. The Rural Credit Survey had recommended State participation in the share capital of primary land mortgage banks as well. It will be recalled that the Bank's Agricultural Credit Department had questioned the necessity for such contributions since primary land mortgage banks were not generally required to raise their own resources and depended entirely on central land mortgage banks to finance them. This view appears to have prevailed within the Bank which did not finance state governments to acquire stock in these institutions. Policy in this regard however underwent a change from 1969, when it became apparent to the Bank that the continued viability of the land mortgage banking structure as a whole depended on strengthening the capital base of primary land mortgage banks. A stronger capital base was expected to enable primary land mortgage banks to absorb at least some of the growing proportion of overdue loans instead of shifting them to the central land mortgage banks, and relieve the latter from having always to finance primary banks out of interim accommodation raised at relatively high rates of interest. The new policy, incidentally, eased some of the continuing pressure on the Bank to finance the working capital requirements of central land mortgage banks. Greater accountability, it was also hoped, would enable primary land mortgage banks to play a more effective role in assessing, monitoring, and recovering loans.

#### *Contribution to Resource Mobilization*

In its early years, the Bank harboured reservations about extending credit of a long-term nature, believing that a central bank should keep its resources liquid at all times. Land mortgage banks raised their resources through the issue of debentures. These were guaranteed by state governments, but the Bank initially remained averse to investing in them. The Bank's view in this regard underwent a change in 1948 when it agreed to buy up to 10 per cent of

the debentures of the Madras Provincial Land Mortgage Bank. The Bank later raised this ceiling to 20 per cent in 1950, though thanks to the public demand for them, it was not required to take up more than 5 per cent of the Madras debentures floated during 1948–50. In 1950 the Bank also supported debentures of the Bombay land mortgage bank to the tune of Rs 4 lakhs out of a total issue of Rs 30 lakhs. The informal conference on rural credit endorsed these initiatives. As central land mortgage banks experienced difficulties in finding buyers for their debentures, in December 1953 the Bank and the Government of India agreed to take up, in equal proportions, the unsubscribed portions of their issues up to a combined maximum of 40 per cent. Although the second plan envisaged a large increase in the target for long-term credit to agriculture, the Government of India discontinued its contributions to these debentures from 1956. The Bank's commitment to supporting these debentures did not waver, however, while institutions like the State Bank of India and the newly nationalized Life Insurance Corporation stepped into the breach caused by the government's withdrawal.

Both the Rural Credit Survey and the Government of India envisaged the Bank playing a bigger role in helping land mortgage banks mobilize resources. The Bank's role in this respect was twofold. It remained an important source of finance for central land mortgage banks, standing by at all times to buy up to a fifth of the debentures they floated. It also helped coordinate the investments of other public bodies such as the State Bank of India, the Life Insurance Corporation, the National Cooperative Development Corporation, and commercial banks. The Bank's role in forming what the All-India Rural Credit Review Committee later referred to as a 'consortium of ... investing agencies' proved particularly crucial during the credit squeeze of the mid-1960s. By 1967, this consortium acquired a quasi-formal character as the Bank began to convene annual meetings of the major institutional investors to work out in advance the distribution of land mortgage debentures between them. Following the Bank's intervention and the growth of 'social control' over banking, commercial banks too began assisting land mortgage banks' debenture issues in a significant way after the mid-sixties. Their acquisition of these assets increased from Rs 0.9 crore in 1965–66 to Rs 3.9 crores the next year, and to Rs 18.1 crores in 1967–68. The interest of the State Bank and the Life Insurance Corporation in these debentures waned in 1966–67 as they felt unable to reconcile the many competing demands on their resources. The Bank stepped in with larger support for these debentures, but this was clearly not enough to offset the recession in the demand for them. Fears that central land mortgage banks might fail to play their role in boosting productive investment in agriculture, especially in the green revolution districts, prompted

the Government of India to resume funding their debentures. The central government bought debentures to the tune of about Rs 8 crores in 1966–67, and Rs 15 crores in each of the next two years.

Ordinary debentures were designed largely to suit the requirements of institutional investors such as banks, insurance companies, and trusts. They were issued in August and September when demand for credit was usually slack and institutions were well endowed with liquid resources. The Rural Credit Survey was concerned to ensure that as well as channelizing resources into agriculture, the new rural credit structure should assist in promoting and mobilizing savings by rural households. The rural debentures scheme was mooted with the latter object in view. In order to prevent the diversion of institutional funds, rural debentures were to be available only to individuals and village panchayats. Unlike ordinary debentures, these were to be floated in the post-harvest season when rural households came into possession of new resources. The other details of the rural debentures scheme were worked out by the Bank in 1958. In its original form, the scheme envisaged central land mortgage banks granting loans to agriculturists for six or seven years against mortgage of land and, to use a latter-day expression, securitizing these mortgages in the form of one or more special series of rural debentures. Rural debentures were to offer a slightly higher rate of interest than ordinary debentures, and be of the same duration as the mortgages they securitized. In order to support and promote rural debentures the Bank agreed to underwrite up to two-thirds of their issue, the resources for meeting the shortfall in public subscription coming out of the Long-term Operations Fund. The Bank also recommended to the government to treat rural debentures on par with National Savings Certificates and exempt the interest on them from income tax.

The first series of debentures under this scheme was floated for Rs 75 lakhs by the central land mortgage banks of Saurashtra, Andhra, and Orissa in 1958. The debentures were for a period of seven years and carried an interest rate of 4.5 to 5 per cent. Public subscriptions amounted to Rs 34 lakhs, of which the bulk was for debentures of the Saurashtra bank. It would be harsh to judge this initial issue a total failure. However, the scheme had to be modified almost from the outset since central land mortgage banks experienced difficulty in bundling together an adequate number of seven-year mortgages, the demand for loans being mostly for durations of fifteen years or more. Following representations from central land mortgage banks and state governments, the Bank convened a meeting of concerned officials from these agencies in August 1958 to formulate a new scheme. Under this scheme, central land mortgage banks were allowed to grant loans for up to fifteen

years. The counterpart rural debentures were to be issued in two parts. The first part, for 7/15ths of the amount, was to be issued to the public for seven years and the balance for fifteen years to the Reserve Bank. The Bank also agreed to accept interest at a lower rate of four per cent on its holdings of rural debentures so that central land mortgage banks might afford a higher rate to the public and evoke a better response from them at the same time as holding down the cost of funds to the eventual borrower.

In spite of modifications to the scheme and the Bank's support, the success of rural debentures remained modest and uneven. Of rural debentures aggregating Rs 17.4 crores issued up to June 1967, public subscriptions amounted to only about Rs 7.4 crores. The bulk of the debentures was also issued by a few central land mortgage banks, the Bombay and Gujarat banks alone, for instance, accounting for Rs 5.5 crores of the rural debentures worth Rs 7.09 crores issued during 1964–67 by eight central land mortgage banks. As many as eight central land mortgage banks were unable to float any rural debentures in the first decade of the scheme. The All-India Rural Credit Review Committee noted that rural debentures were the only area of their activity where central land mortgage banks, who otherwise relied almost entirely on public institutions for their resources, were expected to show some drive and dynamism. Its assessment of the scheme forced the Review Committee to conclude that central land mortgage banks were largely lacking in both attributes.

Central land mortgage banks secured interim accommodation from state governments, the state cooperative bank, or the State Bank of India to finance their mortgage acquisitions which were subsequently securitized in the form of debentures. Many banks found this a cumbersome practice leading, among other things, to delays in the release of loans to primary land development banks and to the ultimate borrower. Efforts to cut delays by crediting funds to primary land development banks before they had sanctioned loans meant, inevitably, some inefficiency in their use and loss of income. Hence, the demand grew for interim accommodation, or short-term working capital, to be extended out of the Bank's Long-term Operations Fund. The Bank believed it would be 'fundamentally inappropriate' for it to provide short-term accommodation to central land mortgage banks since it might mean, in the event of land mortgage banks' debentures attracting poor public support, that it would have no other option than to convert the major part of its short-term loans into debentures and acquire, in the bargain, excessively large proportions of their issues. At the Governor's urging, the Bank's Standing Advisory Committee on Agricultural Credit reiterated at its meeting in February 1957 that state governments and state cooperative

banks would have to continue meeting the short-term requirements of central land mortgage banks.

It was pointed out above that in the early years of their functioning land mortgage banks mainly provided loans for repaying old debts. Although debt relief legislation and rising prices of agricultural produce since the war helped ease the problem of rural indebtedness, redemption of older debts remained the predominant purpose for which long-term loans were issued. The Rural Credit Survey found that in 1951–52, the Mysore land mortgage bank had made no loans at all for productive purposes, while only 14 per cent of the loans of the Madhya Pradesh and a fifth of the loans of the Maharashtra land mortgage banks were not for redemption of past debt. The Survey underlined the importance of reorienting the lending of land mortgage banks towards productive projects, and the Bank lost no opportunity thereafter to reiterate this goal. At the Bank's instance, land mortgage banks were also progressively renamed land development banks in the 1960s in order more accurately to convey the changed role of long-term lending institutions in agriculture.

The proportion to total lending by land mortgage banks of loans for productive purposes rose steadily from less than a fifth at the time of the All-India Rural Credit Survey to 55 per cent in 1957–58 and 70 per cent in 1961–62. The Bank did not believe it was advisable altogether to eliminate loans made to redeem past debts, but remained convinced that more could be done to promote productive lending. After repeated pleas failed to produce the desired effect, the Bank resolved to make its support for their debentures in 1967–68 conditional on central land mortgage banks advancing at least 80 per cent of their loans for productive purposes. The threat appears to have paid off. The classification of loans advanced by central land development banks in 1967–68 showed that over 80 per cent of them were given for 'easily identifiable productive purposes', while another 17 per cent financed 'other productive purposes' such as 'levelling and bunding, land reclamation, fencing, repairs to wells, other land improvements, etc.' Although these figures varied across states, only in Pondicherry did the proportion of loans for non-productive purposes exceed 20 per cent. The latter proportion was sought to be brought down to 10 per cent throughout the country in the course of the following year. Of the total, at least 70 per cent of the loans were to be for 'easily identifiable productive purposes' such as 'sinking of wells, purchase of pump-sets, tractors, and other farm machinery ....'

#### *Formation of the Agricultural Refinance Corporation*

It soon became apparent to the Bank and others following the working and progress of land mortgage banks that they might, unless supported in their

efforts by a larger agency, fail to satisfy the latent demand for productive investment in agriculture. In addition, land mortgage banks were not geared to financing certain types of agricultural investments, for example those in the command areas of irrigation projects and for the development of plantations and horticultural crops. The outlays involved were considerably larger than in other projects and necessitated special terms such as longer moratorium and repayment periods. Some central land mortgage banks were known to finance projects of this nature (notably land reclamations and rubber plantations) by floating special development debentures whose issues the Bank underwrote to the extent of 75 per cent. But special debentures were issued on a modest scale and a majority of central land mortgage banks remained reluctant to get involved in large-scale development projects. The latter required specially tailored loan packages which often necessitated detailed coordination with various development departments of the state government and with short-term lending institutions. Such coordination was often beyond the ability and resources of primary land mortgage banks. Even central land mortgage banks could not be expected to set aside their regular preoccupations and interest themselves in more than an occasional development project requiring large outlays and special terms.

In 1960, the Committee on Cooperative Credit (Vaikunth Lal Mehta Committee) advised examining the possibility of using P.L.480 funds to finance medium- and long-term productive investment in agriculture. Consequently the Bank and the government, which were both concerned to promote longer-term investment in major projects of agricultural development, began to think in terms of a specialized agency to finance such investments along the lines of institutions recently established for the purpose of financing industrial development.

The Governor, H.V.R. Iengar, from the outset was alive to the possibility that the demands of agricultural credit might require the establishment, at some stage, of specialized institutions for the purpose. As he told the Finance Minister, T.T. Krishnamachari, in 1957 during discussions about the relative roles of the Reserve Bank of India and the State Bank in rural credit, the Reserve Bank's current position in the latter sphere was largely the product of a 'historical accident' and an eventual resolution might lie in setting up a separate corporation affiliated to the Bank, to finance agricultural credit. When some in the Government of India wanted the Bank to suspend 'banking principles' and liberalize lending to the agricultural sector, the Governor had said, more in sorrow than in defiance, that it might be better from the country's point of view for a separate corporation to undertake such financing than for the Bank to show many bad debts in its books. However, window-dressing

concerns were not uppermost in the Governor's mind in January 1961, when he mooted to L.K. Jha, Secretary in the Finance Ministry, a proposal to set up a refinancing organization for land mortgage banks, modelled along the lines of the recently established Refinance Corporation for Industry, to fund agricultural development projects such as major land improvement and reclamation, and rubber and orchard plantation.

A major argument in favour of the new corporation was that it would draw financial assistance from sources other than the Bank, including special funds under the P.L.480 programme and public borrowing. Once set up, the refinancing agency could also diversify its operations beyond land mortgage banks, actively helping to finance other institutions like commercial banks as they interested themselves in agricultural development, horticulture, and other non-traditional areas of agricultural activity. Presenting the Bank's scheme to establish a public limited company to finance large but individually profitable schemes of agricultural development, Iengar told the Standing Advisory Committee on Agricultural Credit that the new thrust reflected in this proposal complemented the earlier emphasis which the Bank and the government had placed on promoting short-term agricultural lending through rural cooperatives. However, both he and the Deputy Governor, B. Venkatappiah, affirmed that the new corporation would, at least to begin with, channelize its resources principally through the cooperative credit structure, especially land mortgage banks, and that the Bank would make available to the former, resources additional to those it normally advanced out of its Long-term Operations Fund.

Following discussions with the government, it was decided to organize the new institution as a statutory corporation. Although largely a refinancing agency, the corporation was also enabled by its statute to entertain applications to directly finance projects for which cooperative or even commercial bank finance might not be easily forthcoming. The new institution was not expected normally to lend resources to meet working capital requirements. To match the enlarged scope of the new agency, its paid-up capital was doubled from Rs 2.5 crores to Rs 5 crores, and the membership of its Board raised from seven to nine members, including a full-time Managing Director. The corporation was allowed to hold the Bank's share of its dividend in a special interest-free fund. While central land mortgage banks were expected to be the principal channel for routing the resources of the corporation, scheduled banks were retained among its constituents in preparation for the day when they might take greater interest in schemes for agricultural development. The Committee of the Central Board of the Bank approved the detailed proposal for the corporation in April 1962, and a draft bill incorporating its main features was drafted and sent to the government.

The Agricultural Refinance Corporation Bill, 1962 was introduced in the Lok Sabha in December by the Finance Minister, Morarji Desai, and taken up for discussion in January the following year. Explaining the objects of the proposed corporation, Tarakeshwari Sinha, Deputy Minister of Finance, declared that it would plug a major gap in the existing institutional structure for agricultural credit. She remarked on the close interest the Bank evinced in agricultural development and in the new corporation, and noted the ways in which the latter might benefit from its close association with the Bank. The bill evoked widespread support. Some members questioned the need for the new entity when the Reserve Bank was already playing a major role in agricultural credit. Addressing these and other remarks, B.R. Bhagat, the other Deputy Minister of Finance, observed that the Bank's ability to make long-term loans was limited. There were, besides, many other claims on its resources. A separate corporation, on the other hand, would be able to raise adequate resources as it could borrow up to twenty times its paid-up capital and reserves. He defended the provision for nomination of directors by the Bank by reminding members of the Prime Minister's observation that the new corporation 'has got to be strengthened by the Reserve Bank'. The bill was passed in both houses during the budget session, and received the President's assent in March 1963.

The Agricultural Refinance Corporation opened for business in Bombay on 1 July 1963. D.G. Karve, who succeeded B. Venkatappiah as the Deputy Governor in charge of rural credit, became the first Chairman of the corporation. In his inaugural speech, the Finance Minister anticipated that the new corporation 'will ultimately relieve the Reserve Bank of its function so far as rural finance and agricultural credit is concerned'. However, at least to begin with, the refinancing corporation was very much a creature of the Bank. It had an authorized share capital of Rs 25 crores, of which shares to the extent of Rs 5 crores were issued in the first instance. The Government of India guaranteed both the principal invested in the shares and a minimum annual dividend of 4.25 per cent, thereby granting 'trustee' status to the shares of the corporation. Under the original proposal, the Bank was to take up half the share capital and central land mortgage banks and apex cooperative banks another 30 per cent between them, leaving the remainder for the Life Insurance Corporation and other insurance and investment companies. But trustee status notwithstanding, the latter institutions together failed to pick up their share of half the new corporation's equity, forcing the Bank to make good the shortfall and acquire nearly 60 per cent of its shares. In order to assist its functioning in the early stages, the government placed at the corporation's disposal an interest-free loan of Rs 5 crores, repayable after 15 years in as many equal



instalments. The corporation was also empowered to raise deposits or borrow from the Bank, the government, and others, besides issuing bonds and debentures guaranteed by the government, within a total borrowing limit of twenty times its paid-up capital and reserves.

The corporation formalized its procedures in fairly short order. The list of activities eligible for assistance was long. It included minor irrigation works, reclamation and preparation of land falling under the command areas of irrigation projects; soil conservation, dry farming, farm mechanization, and aerial spraying; development of forestry, horticulture, plantations, and animal husbandry; promoting market yards, godowns, and silos; and dairy and poultry farming, and fisheries. Its assistance was available for periods ranging from three to twenty years and could be provided in one of three ways: (a) refinance to eligible institutions, i.e. central land mortgage banks, state cooperative banks, and scheduled commercial banks who were shareholders of the corporation; (b) direct loans and advances to cooperative societies in exceptional cases, with the approval of the Reserve Bank; and (c) subscriptions to fully guaranteed debentures of eligible institutions. The new corporation was also allowed to guarantee deferred payment for capital goods imported for use in agriculture. The corporation paid special attention to promoting development in regions which had not attracted much attention earlier, and to schemes prepared for the benefit of small and marginal farmers.

In the first four years of its operation, the corporation sanctioned 38 schemes involving a total outlay of Rs 36 crores, of which its own financial commitment was of the order of Rs 29 crores. Its disbursements were, however, much lower at Rs 7 crores during the same period. While central land mortgage banks remained dominant borrowers, state cooperative banks and commercial banks soon began participating more actively. Interestingly, commercial banks, which submitted one scheme in the first two years of the corporation's existence made rapid strides in the next decade. Thanks no doubt to social control and nationalization, the total number of their schemes approved by the corporation in the later period exceeded those of central land development banks and state cooperative banks.

The Bank undoubtedly played a major role in reorganizing the institutional basis of longer-term lending in agriculture. But much of its energies in rural credit, particularly in the early years, were devoted to strengthening and energizing the apparatus for short-term cooperative credit. It is to this segment of the rural credit structure that we now turn our attention.