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Agriculture and Rural Development

INTRODUCTION

In the field of rural credit, the Reserve Bank played a unique role since its inception. The critical importance of agriculture and rural development was also well recognised in the successive Five Year Plans, since growth in this sector helped to improve food security, nutritional standards and the supply of wage goods at reasonable prices. Around the turn of the 1980s, an urgent need was felt for broad-based agricultural and rural development that gave an impetus to allied activities in rural areas, both to generate employment and to alleviate poverty. This prompted the establishment of a specialised apex institution for agriculture and rural development, namely, the National Bank for Agriculture and Rural Development (NABARD) in 1982. Given its statutory responsibility, the Reserve Bank continued to guide the financial system and exercise overall regulation over rural financial institutions in co-ordination with the Government.

Apart from the massive expansion of banking in rural areas during the 1980s, banks were prompted to emerge as social institutions even at the cost of viability. Further, stress was laid on initiating programmes and schemes to develop agriculture and the rural segment with an emphasis on providing assistance to the weaker sections, particularly the scheduled castes (SCs) and scheduled tribes (STs). Programmes such as the integrated rural development programme (IRDP), new twenty-point programme and the differential rate of interest (DRI) scheme were intensified. The lead bank scheme (LBS) was introduced to ensure the flow of bank credit to the priority sector and to co-ordinate the activities of different entities, such as banks and the development agencies of the Government at various levels.

In the early 1980s, the over-emphasis on achieving quantitative targets resulted in weaknesses surfacing and raised concerns about the viability of the banking system. The later part of 1980s, therefore, focused *inter alia*, on the need for qualitative improvements in agriculture and rural credit. Thus, the service area approach (SAA) was introduced in 1989 to improve the quality of the delivery system in rural lending.

With the onset of wide-ranging reforms in the financial sector beginning in the 1990, including liberalisation and deregulation of interest rates based on the recommendations of the Narasimham Committee, the earlier rigour with which rural and priority sector lending was pursued by the Reserve Bank underwent some changes leading to the emergence of alternate models of the rural credit delivery system, such as micro-credit through self-help groups (SHGs) and non-government organisations (NGOs).

IMPACT OF REFORMS

The five year plan remained suspended during the period 1989–1991. Since the focus shifted to crisis management and the introduction of structural reforms in trade, industry and the financial sector, the intensity with which agricultural and rural credit targets and policies were pursued during the 1980s lost their momentum from the early 1990s. On the eve of the 1991 reforms, following the expansion phase during the 1980s, the rural credit delivery system was found to be rather inadequate. Despite the impressive geographic spread and consequent decline in the influence of informal sources of credit, the rural financial institutions were characterised by several weaknesses, *viz.*, a decline in productivity and efficiency and an erosion of repayment ethics and profitability.[1]

The significant increase in credit flow from institutional sources during the 1980s brought forth a strong sense of expectation from the banking system; in particular public sector banks (PSBs). However, this expectation could not be sustained since achieving quantitative targets was in focus through the decade. As a consequence, little attention was paid to the qualitative aspects of lending, resulting in loan defaults by all categories of borrowers and erosion of repayment principles. The result was a disturbing growth in overdues, which not only hampered recycling

1. Mohan, Rakesh (2004). "Agricultural Credit in India: Status, Issues and Future Agenda", *RBI Bulletin.* November.

of scarce bank resources, but also affected the operational efficiency of financial institutions.

Some significant measures in the area of agricultural credit as part of the overall structural reforms initiated in 1991 included: deregulation of interest rates by co-operatives and regional rural banks (RRBs); deregulation of lending rates by commercial banks for loans above ₹ 2 lakh; recapitalisation of select RRBs; introduction of prudential accounting norms and provisioning requirements for all rural credit agencies; increased refinance support from the Reserve Bank and capital contribution to NABARD; constitution of the rural infrastructure development fund (RIDF) in NABARD for rural infrastructure projects; and introduction of the kisan credit card (KCC).

The weaknesses in the performance of rural financial institutions since 1991 prompted the authorities to set up various committees/working groups/task forces to look into their operations. While the Narasimham Committee recommended revamping priority sector targets and rural lending policies, the Government and the Reserve Bank retained the emphasis on the social orientation of banking towards rural and the priority sector. Nevertheless, the overall financial reform measures were accompanied by rationalisation of rural banking policies. The definition of priority sector was expanded by raising the credit ceiling limit, and by widening the coverage to include many hitherto uncovered segments. At the same time, commercial banks were provided with the option of meeting the shortfall in achieving the priority sector target by investing in special bonds issued by certain specialised institutions. Except for a narrow segment of small borrower accounts, interest rate regulations under the priority sector were removed. The branch licensing policy, which had been instrumental in the expansion of commercial bank branches in rural areas, was modified to allow banks to rationalise their branch networks.[2]

As a result of the reform process, the financial health of commercial banks improved. However, commercial banks being more focused on operational viability tended to cherry-pick and give comparatively less priority to marginal and sub-marginal farmers.[3]

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2. Bose, Sukanya (2005). "Rural Credit in India in Peril", in V.K. Ramachandran and Madhura Swaminathan (eds.), *Financial Liberalization and Rural Credit in India.* International Development Economics Associates and Tulika Books.
3. Thorat, Y.S.P. (2005). *Rural Credit in India and Concerns*. Presidential Address at the Indian Society of Agricultural Economics. Ludhiana: NABARD. November 24.

POLICY CONCERNS

Despite these shortcomings in the rural credit system, the agricultural performance during the 1990s was the equivalent of a long-term trend value. It was, however, moderate in the context of economic reforms, and could be considered as sustainable. The overall agricultural production index rose by 2.8 per cent and that of food grain production by 2.2 per cent. The growth rate in food grain production was close to the long-term growth rate in demand for food grains. A significant aspect of agricultural production in the 1990s was the minimal fluctuation in output, which was mainly due to a series of reasonably good monsoon seasons. Equally important was the fact that the increase in output, particularly in food grains, was contributed by a large number of states. The gradual opening up of agriculture to world markets, with its favourable impact on terms of trade for agriculture, created a progressively conducive environment for improvement in agricultural production. Further opening up of the economy, it was felt, required a sharp acceleration in the agricultural performance, which could be realised only with a strong policy package.

Public investment in rural development was constrained by the overall fiscal position, even though the Centre's budgets had allocated higher outlays for agriculture, rural development and irrigation and also raised the capital base of NABARD and RRBs. The state governments too had to make larger investments in rural infrastructure by managing their finances better through cost recoveries and resource mobilisation. Besides, private investment had to go up. The policy concern was about not merely sustaining the present rate of public investment in agriculture, but also improving the same, should there be a dip in private investment for any reason.

With the recapitalisation and adoption of prudential norms, attempts were made to strengthen RRBs. To create a favourable recovery culture, weightage was given to recovery performance in staff appraisals and attempts were made to evolve legal mechanisms for expeditious disposal of cases filed for recovery of dues. Strict observance of the memoranda of understanding (MoU) signed between NABARD, the state governments and the state co-operative bank/state land development bank (SLDB) and between the RRBs and sponsor banks was considered critical for strengthening the organisational base and the operating practices of rural financial institutions. The co-operative credit system was freed from interest rate controls except for the prescription of a minimum lending rate.

The policy instruments deployed to promote agricultural growth, *viz.*, prices, subsidies and procurement, were reviewed, and simultaneously other aspects, such as storage, technology and infrastructure needs relating to the agricultural sector, were addressed. The review showed that the major factors that constrained the capacity of the poor to borrow from organised credit institutions were lack of skills, lack of awareness about economic opportunities and markets and their inability to overcome intricate procedural requirements. In this regard, the role of voluntary agencies and NGOs in financial intermediation became increasingly important.

The annual growth rate in the output of food grains since the beginning of the 1990s at 1.7 per cent was marginally lower than the population growth rate at 1.9 per cent. Given the growth in the labour force, agricultural production had to expand at a secular rate of about 4.5 per cent per annum to maintain the momentum of the overall economic activity. Such an outcome would require productivity in agriculture to be enhanced. In this context, a number of considerations were evaluated by policymakers.

First, agriculture in India traditionally exhibited persistent, large inter-state differences in productivity levels across all crops. Such inter-state variations needed to be bridged quickly. Second, the expeditious creation of irrigation potential on so far un-irrigated lands and the holistic development of extensive rain-fed areas needed focus. Third, further opening up of agricultural product markets through removal of controls and regulations, such as those imposed on inter-state movement, exports, trade and storage, would empower farmers to realise more remunerative and profitable returns on their produce. To minimise price volatility in agricultural products, futures trading in specific commodities would need to be pursued vigorously. Further, agricultural products accounting for nearly 20.0 per cent of total exports would warrant a special thrust in overall export promotion efforts.

The long-term capital required for funding large and medium irrigation schemes and rural infrastructure had to flow from increased budgetary outlays at both the central and state levels. Further, the system of subsidising agricultural inputs required restructuring so that direct investment in productive assets, particularly in irrigation, power and rural roads could increase. Institutional credit agencies were required to support land improvement, irrigation projects and farm mechanisation on a larger scale. Commercial banks, on their part, had to meet the lending targets set

for agriculture to help promote balanced development of all major sectors of the economy.

Regional imbalances in agriculture were a source of concern. Since rural lending was essentially risk-prone, the availability of finance and application of technology had to go hand-in-hand, and supplementing agricultural income by non-farm and farm-related activities was particularly important.

Environmental degradation reflected in the diminution of tree cover, growing scarcity of non-commercial energy resources and soil erosion received increasing attention during the 1990s. There was a need for developing better land use policies, encouraging social forestry and developing waste lands. The involvement of rural credit institutions in such activities was minimal. While a major part of these programmes was to be financed through budgetary resources, it was necessary for rural credit institutions to identify and support the projects that were bankable.

The lack of adequate marketing facilities was a major constraint in the rural economy, although over the years, roads and transportation facilities, public procurement and distribution systems, particularly for food grains and co-operative marketing for select produce, had shown marked improvement. However, the growth of agro industries and other non-farm activities required further strengthening of the linkages in production and marketing. It was, therefore, felt that the role of private trading and the services sector required special emphasis and consequently, the involvement of credit agencies with trade and marketing finance should increase.

Low credit-deposit ratios persisted in several regions, despite the efforts of the commercial banking sector. Areas that generated large deposits did not always have a correspondingly high credit demand. The high incidence of loan repayment defaults was also a constraint on lending. While bankers were prepared to lend, the low credit absorption capacity of deficient regions was a major handicap. This was an area of concern for policymakers.

Although the concern of the Government and the Reserve Bank to alleviate poverty was reflected in the policies, plans and their execution involving the banking system in the early 1990s, there was also a visible shift in their approach in the late 1990s when the need to run the banking system along professional lines was felt to ensure its viability and sustenance. The inadequacy of loan recovery continued to afflict the rural credit institutions, and the policy initiatives to make these institutions self-financing did not

succeed. Their operational problems got aggravated, despite the increasing stability of agricultural production. The loan repayment record of large borrowers was particularly unsatisfactory. The question of the viability of institutions engaged in rural lending and related issues about their costs and the price of loans continued to receive the attention of the Reserve Bank and the Government.

FOLLOW-UP TO THE AGRICULTURAL CREDIT REVIEW COMMITTEE

Under the administered interest rate structure, the increase in lending at concessional rates and high reserve requirements had put considerable pressure on the operational efficiency of banks. The agricultural credit review committee (ACRC)[4] took the view that the lending rates were generally un-remunerative for credit institutions, especially the RRBs and co-operative credit institutions, and suggested that in the agricultural sector there should be two rates, *i.e.*, a concessional rate for small and marginal farmers and a general rate for others. The report also dealt with greater autonomy to banks in financing anti-poverty programmes, interest rates on agricultural advances, merger of RRBs with sponsor banks and setting-up a National Co-operative Bank of India (NCBI), Agricultural and Rural Development Corporations for the eastern and north-eastern regions and establishing a Crop Insurance Corporation (CIC). These were examined by the Reserve Bank and the issues were brought to the Government's notice through a communication dated April 28, 1990.

On the issue of autonomy of banks in financing anti–poverty programmes, the Reserve Bank agreed with the committee's recommendations and stated that there should be no upward revision in the targets set for such programmes. On interest rates, costs and margins, the Reserve Bank was of the view that the concessionality in the rate of interest should be extended to all small borrowers and the rate of interest on agricultural advances be raised to improve the viability of lending operations. The World Bank staff, while holding discussions on the committee's report with the Reserve Bank and NABARD in December 1989, also seemed to take this view, although they had reservations on some rates, which they felt were far below the market rates and might result in excessive demand and diversion of credit to unproductive purposes. The

4. The recommendations of the agricultural credit review committee (Chairman: Dr A.M. Khusro) have been dealt with in detail in chapter 8: Rural Credit Policy and in Appendix 8.1.

Reserve Bank, however, felt that the World Bank's reservations could be substantially overcome if the concessional rate was fixed at 11.5 per cent as per the committee's recommendations. The Reserve Bank also felt that the proposed interest rate structure would reduce, to some extent, the losses suffered by banks in their lending to weaker sections.

On the recommended scrapping of the DRI scheme, the Reserve Bank was agreeable to accepting it because the banks sustained a loss of ₹ 50 crore per annum on their DRI loans and the scheme had outlived its utility. The Reserve Bank was of the view that the beneficiaries eligible under the DRI scheme could be assisted under the IRDP in rural areas and the self-employment programme for urban poor (SEPUP) in other areas. On the recommendation of the committee to merge RRBs with their sponsor banks, the Reserve Bank was in agreement and opined that although the initial cost to commercial banks would increase as a result of the merger, the quality of operations would improve and the sponsor banks would be able to provide a measure of cross-subsidisation. The Reserve Bank, however, did not favour setting-up of an NCBI or ARDCs, in light of the fact that multiplicity of administrative agencies for discharging development functions could lead to an overlap. The Reserve Bank was apparently also not enthusiastic about the Government's proposal to merge all RRBs into a National Rural Bank of India (NRBI), since RRBs had continued to be non-viable.

Of the 196 RRBs, only 44 banks were able to achieve marginal profits, while 152 banks registered losses amounting to ₹ 550 crore and 134 banks suffered erosion in their deposits. The weakness of RRBs was further accentuated by the increase in pay and allowances of their employees on par with those of sponsor banks in terms of the award of the national industrial tribunal (NIT). On account of the NIT award, the pay and allowances of RRB employees were to increase by 60.0 to 65.0 per cent during 1993–94.

PROPOSAL FOR A NATIONAL CO-OPERATIVE BANK OF INDIA

The proposal to set up a NCBI was submitted to the Government and the Reserve Bank by the promoters of the bank. The principal objective envisaged for the NCBI was to function as a central financing agency for its constituents that would: (i) operate as a national balancing centre and spokesperson of the co-operative banking and finance system; (ii) act as a receptacle for surplus resources of the state systems; and (iii) deploy

these and other resources through consortium and other arrangements. This was expected to provide systemic strength to the co-operative credit structure in the country. The proposal and the viability of the proposed bank were examined and a committee of the Deputy Governors also held detailed discussions with the promoters of the NCBI in September 1991.

It was observed that the main resources of the NCBI were to be raised through investment of 50.0 per cent of statutory liquidity ratio (SLR) of the state co-operative banks to be kept with it. The SLR consisted of investments in government and other approved securities and there was no reason to believe that the state co-operative banks would divert these resources to the NCBI. Apart from this, such banks would hardly have surplus resources to invest in the NCBI. Their reserve fund and other funds were locked up and, even if some state co-operative banks and larger co-operative organisations had funds to spare, it was likely that they would seek investment avenues that could fetch much higher returns than the 12.0 per cent that the proposed NCBI would offer. The promoters had also assumed that in due course ₹ 80 crore would be available from the state co-operative banks and ₹ 30 crore from other larger co-operative institutions. It was felt that these resources may or may not be available and such funds, therefore, could not form a firm resource base and would fetch the NCBI very little margin, if most of the return had to be passed on to the state co-operative banks and other organisations.

The Reserve Bank took the view that the proposed NCBI without the state co-operative banks investing 50.0 per cent of their SLR with it would not be a viable organisation, far less than the one with a strong resource base of its own that was worthy of a national bank. Another point made by the promoters was that the NCBI would bridge a systemic gap caused by the absence of a national-level institution. On examining the issue, which was also brought out in the ACRC report, it was observed that there was no significant systemic gap and certainly not any as to warrant the establishment of another bank. The Reserve Bank did not, therefore, accept the proposal for setting-up of an NCBI on the following grounds:

(i) The so-called surplus resources of the state co-operative banks seemed to be illusory. The state co-operative banks that had surpluses were already participating in a food credit consortium and other consortia that were financing IFFCO and KRIBHCO.[5]

5. IFFCO: Indian Farmers Fertiliser Co-operative Ltd; KRIBHCO: Krishak Bharati Co-operative Ltd.

(ii) SLR and reserve funds were invested in an approved manner, and diverting these investments from government securities and re-routing them through another institution might not add substantially to the aggregate resources available to the system.

(iii) NABARD as the apex development bank had been providing financial assistance and taking several policy initiatives as per national priorities and programmes.

(iv) Regarding co-ordination and the need for a spokesperson of the co-operative movement at the national level, the existing federation of state co-operative banks and SLDBs could adequately serve the purpose.

PROPOSAL FOR A NATIONAL RURAL BANK OF INDIA

The salient features of the proposal for the NRBI included: (i) The NRBI was to be formed either as a company incorporated under the Companies Act as a subsidiary of NABARD or as a corporation through an Act of Parliament with a share capital of ₹ 200 crore, which would be contributed by NABARD (76.0 per cent) and employees of NRBI (24.0 per cent). (ii) To ensure its long-term viability, the NRBI would be allowed to finance 40.0 per cent of its incremental advances to non-target group borrowers in addition to part of the resources being deployed in 'corporate advances', *i.e.*, consortium lending such as agri-business consortium and food consortium. (iii) The staff of RRBs would be transferred to the NRBI. The deputed staff (from the sponsor banks) would continue for some time. (iv) To enable the NRBI to start on a clean slate, the accumulated losses (₹ 550 crore) and national industrial tribunal (NIT) award arrears (₹ 220 crore) would have to be neutralised. The proposal envisaged a write-off of sponsor bank refinance (₹ 367 crore), payment of ₹ 1 per RRB as nominal compensation to existing shareholders and meeting the balance of loss from new equity of NRBI. (v) In addition to the refinance from NABARD, the resource requirement of NRBI would be supplemented by:

(i) PSBs placing 10.0 per cent of their incremental rural deposits with the NRBI at the Bank Rate. This will be about ₹ 500 crore per annum.

(ii) Foreign banks and private sector banks transferring around ₹ 300 crore and ₹ 180 crore, respectively, annually to NRBI at the Bank Rate to cover the shortfall under their priority sector lending.

(iii) An annual contribution of ₹ 100 crore from the national rural credit (NRC) long-term operations (LTO) fund maintained by NABARD or an outright grant from the Government.

A meeting of representatives of the Government, major sponsor banks of RRBs and NABARD was convened at the Reserve Bank on August 28, 1992 to consider this proposal. It was decided that working groups would be formed, with representatives from the Government, NABARD, Indian Banks' Association (IBA) and major sponsor banks to consider the financial and organisational aspects of the proposal. The reports submitted by the groups were examined by a steering group at its meeting on September 21, 1992. The steering group, *inter alia*, highlighted the following points:

(i) NRBI should comply with capital adequacy norms. The issue and paid-up capital should be enlarged to ₹ 50 crore and should be held by the Government, NABARD, financial institutions (FIs)/PSBs and RRB employees in the proportion of 51: 25: 15:9, respectively.

(ii) In order that the new bank started on a clean slate, in addition to the losses at ₹ 550 crore worked out with reference to March 1992 working results, additional losses of RRBs during 1992–93 estimated at ₹ 300 crore would also have to be neutralised or made good by the Government in addition to the NIT award arrears estimated at ₹ 220 crore and bad debts of about ₹ 198 crore.

(iii) To enable NRBI to increase its corporate lending, SLR requirement could be reduced from 25.0 per cent to 20.0 per cent.

(iv) Regarding the organisational structure, it was felt that the head office of the NRBI should be either in Pune or Hyderabad and it should function through 15 zonal offices. The head offices of RRBs would function as the regional offices of the NRBI, with necessary adjustments regarding the number of branches under the control of each regional office. The group also recommended that the existing staff of sponsor banks should continue with the NRBI on deputation. If a prima facie view was taken to establish the NRBI, both the working groups and the steering group felt that it would be necessary to study various preparatory measures such as organisational/administrative set up, systems and procedures, motivational and work norms, legal aspects and financial structure and viability.

The viability of the NRBI was worked out on certain assumptions such as: a minimum lending rate of 13.5 per cent, as against the 11.5 per cent being charged earlier, NABARD to provide a return of 17.5 per cent

on SLR deposits of the NRBI, provisioning for bad debts at an aggregate of 2.5 per cent only and availability of refinance from the Reserve Bank through a general line of credit (GLC). The steering group had expressed apprehensions about the realisation of these assumptions. It was concluded that the NRBI would not be viable.

APPROACH OF THE NARASIMHAM COMMITTEE

The Narasimham Committee made some strong recommendations on agricultural credit extended by the banking system. The committee felt that the institutional credit to the agricultural sector purveyed by commercial banks, co-operatives and RRBs was afflicted by the overdues syndrome that had over a period of time debilitated the process of recycling of funds. The implementation of the agricultural and rural debt relief scheme (ARDRS), 1990 further accentuated the problem of recovery and, with co-operative credit societies not being able to mobilise adequate deposits to meet credit needs, implied greater recourse to refinance from NABARD/ the Reserve Bank. This coupled with the fact that the rates of interest stipulated for agricultural advances were not only non-remunerative but also did not cover the cost of funds and other expenses incurred by the credit institutions, eroded their profitability.

While directed credit programmes played a useful role in extending the reach of the banking system to cover neglected sectors, there was a need to re-examine their continued relevance, at least with respect to sectors that did not require access to directed credit and, more so, at concessional rates. Accordingly, the committee recommended that the directed credit programmes be phased out. From the objective of redistributive justice, the committee opined that the instrument of the fiscal system rather than the credit system be used. The committee recommended that the priority sector could be redefined to comprise small and marginal farmers, tiny sector of industry, small business and transport operators, village and cottage industries, rural artisans and other weaker sections, and the credit target for this redefined priority sector should be fixed at 10.0 per cent of aggregate credit. To ensure the flow of credit to sectors excluded from the redefined priority sector, the committee recommended the introduction of a refinance facility from the Reserve Bank.

A detailed assessment by the Reserve Bank indicated that credit to the redefined priority sector would account for significantly more than 10.0 per cent of total advances. Hence, acceptance of the committee's recommendation would put a severe squeeze on the sectors within the

redefined priority sector. For instance, if advances for farm mechanisation, advances over ₹ 10 lakh to small scale industries (SSIs), advances over ₹ 5 lakh to small road and water transport operators and advances to professional and self-employed persons were excluded from the priority sector, the ratio of the redefined priority sector advances to net bank credit as at the end of March 1990 would work out to a little less than 30.0 per cent. If advances over ₹ 2 lakh to agriculture, SSIs and transport operators and all advances to professional and self-employed persons were excluded from the priority sector, the ratio of residual advances to net bank credit would work out to 25.0 per cent.

There was little merit in drastically reducing the target for the priority sector and then meeting the requirements of these sectors through refinance from the Reserve Bank, as this would increase the amount of created money, thereby fuelling inflationary pressures. From a pragmatic viewpoint, it was essential to ensure that any change in the policy on priority sector credit did not disrupt the flow of credit for productive purposes. The stipulations on reserve requirements had implications for the actual credit available for priority sector lending. The incremental reserve requirements were reduced from 63.5 per cent in 1991–92 to 45.0 per cent in the first half of 1992–93 and further to an effective requirement of 25.0 per cent in the second half of 1992–93 (after adjusting for the release of SLR/CRR). For example, on the basis of the effective reserve requirements for the second half of 1992–93, an incremental priority sector allocation of, say, 30.0 per cent would imply that 22.5 per cent of banks' incremental deposits would be available for the priority sector. Similarly, 40.0 per cent allocation in 1991–92 implied an allocation of 14.6 per cent of incremental deposits to the priority sector.

It was, therefore, decided to continue with the existing targets for priority sector lending. Concessional finance was, however, limited to small loans below ₹ 2 lakh and for DRI advances. For advances above ₹ 2 lakh, banks were free to charge interest rates linked to the prime lending rate (PLR). The scope of priority sector lending was enlarged to include finance to state industrial development corporations (SIDCs)/ state finance corporations (SFCs), refinance to RRBs by sponsor banks and investments in bonds issued by certain specified institutions.

From a pragmatic viewpoint, it was felt that there was a case for reviewing the coverage and targets for priority sector lending. Once the micro-regulation of credit delivery was given up and banks were given freedom in matters relating to credit, the discipline of priority sector

lending and the flow of credit to the needy and deserving on a timely basis could get neglected. The activities eligible for priority sector lending should, therefore, be enlarged. With interest rates deregulated and alternative avenues of investment permitted, priority sector lending would become far more flexible.

The Reserve Bank kept the overall stipulation of priority sector lending at 40.0 per cent of net bank credit and the sub-target at 10.0 per cent of net bank credit for weaker sections unchanged. However, some changes were effected in the composition of such lending. It was decided to club 'direct' and 'indirect' categories of advances for agriculture within the sub-target of 18.0 per cent for agricultural lending as a whole, subject to the stipulation that the 'indirect' category should not exceed one-fourth of the sub-target of 18.0 per cent, *i.e.*, 4.5 per cent of net bank credit. Indirect agricultural advances exceeding 4.5 per cent would, however, be reckoned as part of the overall priority sector lending while evaluating the bank's performance against the target of 40.0 per cent. With the revision in the definition of SSIs, it was decided to treat all advances granted to SSIs with investment in plant and machinery up to ₹ 60 lakh (₹ 75 lakh in the case of ancillary units and export-oriented units) as priority sector advances. In order to ensure adequate flow of credit to smaller units, it was decided that each bank should deploy at least 40.0 per cent of total credit to SSIs to cottage industries, *khadi* and village industries, artisans and tiny industries with investment in plant and machinery up to ₹ 5 lakh and other SSI units availing of credit limits up to ₹ 5 lakh.

INTEGRATED RURAL DEVELOPMENT PROGRAMME AND RELATED SCHEMES

The recovery performance of PSBs in respect of IRDP loans had been deteriorating over the years. The cumbersome lending procedures, inadequate supervision and, at times, the apathy of bank staff resulted in delayed and untimely credit, which was responsible for large-scale misutilistion and default of credit. Generally, the recovery to demand ratio with regard to these poverty alleviation programmes was very low. The recovery under IRDP was below 30.0 per cent. There were several reasons for the low recovery performance of the banks. Evaluation studies of the IRDP in particular revealed that the main reasons were incorrect identification of beneficiaries and activities, inadequate availability of proper infrastructure and lack of adequate marketing facilities. Several

studies indicated that the percentage of beneficiaries of IRDP who might have crossed the poverty line was around 20.0 per cent. The 'target-oriented' approach had also compromised the quality of the programmes. Misutilisation of funds through diversion or non-creation of assets and selection of activities for financing without proper reference to their viability had also been observed.

MEHTA COMMITTEE

Several modifications were made in the IRDP to take care of some of these deficiencies. The Reserve Bank constituted a committee on September 29, 1993 (Chairman: Shri D.R. Mehta) to review the progress of the IRDP and recommend measures for its improvement. The terms of reference of the committee were: (i) to review the procedure for identification of beneficiaries under IRDP and suggest changes to ensure proper identification; (ii) to review the existing system of sponsoring loan applications; (iii) to examine the adequacy of forward and backward linkages, and the role of government agencies; (iv) to examine the procedure for sanction of loans by banks and suggest improvements to ensure timely and adequate credit; (v) to examine the causes of poor recovery and suggest measures for its improvement; and (vi) to examine the procedure for disbursement of subsidy under IRDP, *i.e.*, a switch from front-end subsidy to back-end subsidy.

The expert committee in its report suggested far-reaching changes to make the IRDP more effective. The most significant recommendation of the committee was that since all the poor were not alike, they should be segmented into two categories. The category of extremely poor, with no experience in handling assets and who lacked skills should be helped initially through wage employment schemes. The other class of poor who were below the poverty line but slightly better-off and had skills and experience in handling assets could be put on the self-employment route under the IRDP. The other recommendations of the committee, *inter alia*, included: (i) a switch from a front-end to a back-end system of subsidy to avoid misutilisation of funds; (ii) linking a percentage of subsidy allocation to recovery performance; (iii) enhancing both the loan and the subsidy provided under IRDP; (iv) making a provision to extend credit for acquiring land or meeting working capital requirements; and (v) associating voluntary organisations and SHGs with the implementation of the IRDP. The recommendations of the committee were examined by the Government and the Reserve Bank.

Most of the recommendations were implemented. Further, the Government accepted the recommendation for a switch from a front-end subsidy to a back-end system of subsidy. The important measures undertaken in pursuance of the recommendations included the following: banks would provide loans to IRDP beneficiaries to acquire land; short-term credit to meet current farm expenditure and working capital requirements would be taken into account while sanctioning loans to IRDP beneficiaries; suitable cash credit limits would be sanctioned along with term loans; and the cash disbursement system might be extended throughout the country. The purchase committees where the cash disbursement system was in vogue were dispensed with. The repayment schedule was made realistic after giving due weight to the level of income generation and economic life of the assets and the minimum repayment period for an IRDP loan was raised from three years to five years. Initial moratorium was also provided, where required.

The banks would provide group loans for various activities under the IRDP, including assistance for infrastructure. The security required and the rate of interest on such loans would, however, be related to the per capita quantum of loan. Further, the Government decided to allow a subsidy of up to ₹ 1.25 lakh or 50.0 per cent of the project cost, whichever was lower, to a group of a minimum of five members belonging to below poverty line (BPL) families. The banks would provide a second dose of assistance to IRDP beneficiaries who could not cross the poverty line in the first instance and had not been in default. In 1994–95, banks assisted 22 lakh beneficiaries, of which 11 lakh beneficiaries belonged to SCs/STs and 7 lakh were women.

The Government abolished the cut-off point for IRDP assistance whereby any family with an income below the poverty line of ₹ 11,000 per annum would be eligible for assistance under IRDP, subject to fulfilling other pre-requisites such as motivation, entrepreneurial skill and aptitude. From 1995–96, the Government fixed credit targets rather than physical targets for the states/union territories (UTs) under IRDP.

The recovery performance of IRDP loans was generally poor, except for the year 1991 when loans were waived under the ARDRS and showed higher recovery. The advances from commercial banks under IRDP showed a decline during the 1990s. These advances, which grew steadily during the 1980s, reached a peak of ₹ 3,142 crore in 1987, and thereafter gradually declined to ₹ 1,112 crore in 1998.

CHANGE OF APPROACH IN INTENSIFYING RURAL CREDIT UNDER THE SERVICE AREA APPROACH

After the SSA scheme was introduced, the Reserve Bank advised banks in August 1993 to evaluate its impact at the grassroots level, identify operational difficulties and suggest ways to overcome the same. It was found that the SAA was generally acceptable with some modifications. The salient features of the modified SAA were: (i) block-wise grouping of service area branches without disturbing their service area identities; (ii) opening of mobile or satellite offices in large service areas; (iii) enlarging the area of operations of specialised branches to optimise their infrastructure facilities; (iv) re-aligning scattered service areas; (v) exempting large projects that covered several states or districts from SAA; and (vi) freeing RRBs with disbursals of less than ₹ 2 crore during 1992–93 from their service area obligations. However, the remaining RRBs were allowed to operate within the entire command areas (districts), subject to the obligation of extending financial assistance in their respective service areas.

To make the approach more effective, specific steps were taken during 1994–95: (i) commercial banks' designated branches were required to extend financial assistance to beneficiaries under the IRDP and priority sector up to March 31, 1996 wherever RRBs were unable to meet their obligations; (ii) the decision about whether or not a particular RRB was capable of meeting the obligation in disbursal of credit was to be taken by the concerned district consultative committee (DCC); (iii) RRBs that had branches in more than one district should convey decisions regarding their inability to meet the credit obligation to the Reserve Bank which, in turn, would identify designated branches of the commercial bank to meet their requirements; (iv) the unachievable IRDP targets of RRBs that were unable to meet their disbursal obligations should be included in the annual credit plans (ACPs) of the designated branches of the commercial bank.

The Reserve Bank made the reporting system more effective and useful under the service area monitoring and information system (SAMIS) by persuading banks to regularly submit their lead bank returns (LBRs). A provision was introduced in the returns for details on the advances to women beneficiaries. Besides, the designated branches of commercial banks would continue to extend financial assistance to beneficiaries under the IRDP and priority sector lending until end-March 1997 wherever RRBs were unable to meet their obligations of credit disbursal.

The essence of credit planning under the SAA was the thrust given to integrated development through full exploitation of the available resources

and skills that could be created in the assigned area. Although government-sponsored programmes like the IRDP, self-employment scheme for educated unemployed youth (SEEUY) and state-level special programmes continued to dominate branch credit plans, it was reiterated that if the ultimate objective of SAA was to be achieved, bankers should convince the collaborative agencies in the Government about the imperative need to build the portfolio of productive programmes and projects for the target group beneficiaries instead of merely aiming at fulfilling numerical targets.

Besides the poverty alleviation and other government programmes, it was suggested that SAA should consciously plan and achieve channelling of credit for diversification of the rural economy. The Eighth Five Year Plan attached greater importance to market-oriented commercial agriculture. Horticulture, production of oilseeds and pulses, dry land farming and processing and marketing systems were envisaged to be upgraded and encouraged with a view to secure benefits of value addition for the farming community. Further, the pace of rural industrialisation was required to be accelerated to reduce growing unemployment in rural areas. The qualitative change in rural development should get reflected in the SAA and in the performance budget of the banks, it was proposed.

The lending programme of co-operatives had to be aligned with the service area plans prepared by commercial banks/RRB branches. Commercial banks should not ignore the lending programmes of co-operatives while preparing their credit plans, but should take into consideration the co-operatives' longer history of lending in rural areas, their familiarity with the rural environment and their volume of credit through both crop loans and term loans for agriculture and allied activities.

Major expectations from the decentralised credit planning through SAA included: organised and planned mobilisation of resources based on continuous assessment of potential in a homogeneous and compact area; eliminating the diffusion of resources and duplication of efforts by delineating the command area for each rural and semi-urban branch of a commercial bank including the RRB; integrating the role of co-operatives, RRBs and commercial banks in the delivery of credit by preparing a credit plan for each service area with the objective of better productivity in diversified economic activities and enlargement of rural income on a durable basis; close monitoring of the end-use of credit and assessment of its impact on production and income levels; and securing commitment, motivation and empathy for the rural community among the rural bankers on one hand and effective co-ordination with the other developmental

agencies at the field level on the other. The SAA was expected to lead to better quality of lending in terms of higher productivity, income and, above all, efficient recycling of credit.[6]

OTHER WELFARE-ORIENTED PROGRAMMES

The Government and the Reserve Bank made several attempts to mitigate poverty and to create employment opportunities using the banking system in the 1990s through several programmes under the priority sector, which included: advances to weaker sections and special assistance programmes, the DRI, the Prime Minister's rozgar yojana for educated unemployed youth (PMRY), the scheme for urban micro-enterprises (SUME), SEEUY, Nehru rozgar yojana (NRY), urban basic services for the poor (UBSP) and the Prime Minister's integrated urban poverty eradication programme (PMIUPEP). These programmes were intensified/introduced, but they could not make much headway.

While presenting the budget for 1990–91, the Union Finance Minister observed that the economy's first priority was to create employment opportunities. In the 1980s, the economy grew at around 5.0 per cent. The employment statistics, however, presented a dismal picture. According to a report of the National Sample Survey Organisation (NSSO), the number of persons chronically unemployed increased from 8 million in 1983 to 12 million in 1987–88. Further, a vast number of persons were underemployed and their earnings fell well short of a decent minimum. In this context, the Finance Minister emphasised:

> Every citizen has the right to productive and gainful work in order to live meaningfully and with dignity. We would like to introduce an Employment Guarantee Scheme. However, the cost of doing so in all parts of the country are huge, and we do not have the necessary resources at this juncture. Nevertheless, it is proposed to make a beginning on an Employment Guarantee Scheme for the drought-prone areas and areas with an acute problem of rural unemployment. The allocation for the employment schemes of the Department of Rural Development will be supplemented, to the extent feasible, during the course of the year.

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6. Malhotra, R.N. (1990). *Service Area Approach*. Valedictory Address at Trainers' Training Programme in Service Area Approach. Bombay: NABARD. August 18.

A new scheme was proposed in the Union Budget, 1995–96 to meet the credit needs of STs in predominantly tribal districts, for which NABARD would open an exclusive short-term seasonal agricultural operations (SAO) line of credit for central co-operative banks (CCBs) and RRBs. A sum of ₹ 400 crore was earmarked for this purpose during 1995–96. NABARD also earmarked ₹ 150 crore to provide refinance to commercial and co-operative banks for the development of SCs and STs, which was raised to 100.0 per cent from the earlier limit of 90.0–95.0 per cent.

The swarna jayanti shahari rozgar yojana (SJSRY) came into operation in January 1997 through a restructuring and streamlining of earlier urban poverty alleviation programmes.

PREPARING EX-SERVICEMEN FOR SELF-EMPLOYMENT (PEXSEM)

The basic objective of the PEXSEM scheme was to provide technical and financial assistance to retired defence personnel settled in rural areas so as to help them take up self-employment close to their homes. Financial assistance of up to ₹ 25,000 was made available under the scheme to trained service personnel by scheduled commercial banks (SCBs). The sainik boards gave a capital and interest subsidy under the scheme. The scheme was introduced in 1992–93 in certain districts of the country. The coverage of the scheme for each year was decided by the Ministry of Defence, Government of India.

PRIME MINISTER'S ROZGAR YOJANA FOR EDUCATED UNEMPLOYED YOUTH

The PMRY scheme was introduced in 1993 to provide sustained self-employment in micro-enterprises to both rural and urban unemployed youth who were resident in the area for more than three years, with family income not exceeding ₹ 24,000 per annum. The scheme was extended throughout the country from April 1, 1994. The SEEUY was subsumed under this scheme in April 1994. This scheme provided for reservation of 22.5 per cent and 27.0 per cent for SCs/STs and other backward classes (OBCs), respectively. Around 30,000 applications were sanctioned against the target of 42,040 as at the end of March 1994. The target for the year 1994–95 was fixed at 2.39 lakh beneficiaries. In 1995–96, commercial banks sanctioned ₹ 1,648 crore to 2.84 lakh applicants and disbursed ₹ 1,013 crore.

SMALL SCALE INDUSTRIES

THE NAYAK COMMITTEE

SSIs accounted for nearly 40.0 per cent of the gross turnover of the manufacturing sector, 45.0 per cent of manufacturing imports and 35.0 per cent of total exports from the country. The limited access of SSIs to institutional finance was a major policy concern. A committee set up by the Reserve Bank in December 1991 to look into the credit requirements of the SSI sector (Chairman: Shri P.R. Nayak) submitted its report in September 1992. The terms of reference of the committee included: (i) examining the adequacy of institutional credit (both for working capital and term loans) to the SSI sector; (ii) the need for modifications/relaxations in the norms prescribed by the Tandon/Chore Committees for SSIs; (iii) revision, if any, required in the existing Reserve Bank guidelines for the rehabilitation of sick SSI units; and (iv) any related matters.

The committee suggested that small unregistered units with credits limits of not more than ₹ 1 lakh should have the first claim on priority sector credit to SSIs, and the new priority sector credit dispensation, when adopted, should fully provide for the working capital requirement of all tiny units with credit limits up to ₹ 10 lakh. It also recommended that the working capital needs of other SSIs at 20.0 per cent of the output should be pre-empted by commercial banks through an annual budgetary exercise and, if necessary, a part of the resources that was flowing to the medium and large industries sector should be diverted to fully meet the demands of SSIs.

While the growth in the resources of the commercial banking system during the Eighth Plan period would, in the committee's view, adequately take care of the growth in working capital requirements as also the likely extent of a resources constraint, the committee recommended that various measures might be considered, such as a part of the freed SLR being used for SSIs, funds being provided by the Central Government, or a supplementary refinance window being provided by small industries development bank of India (SIDBI)/NABARD. The committee opined that the norms for inventory and receivables (as per the Tandon Committee), which had little relevance for a vast majority of SSIs, should not come in the way of SSI units getting at least 20.0 per cent of their turnover as working capital from the banks. Further, introducing special norms for SSI units in the north-eastern and hilly regions could also be considered.

To overcome the operational difficulties of SSIs, the committee had made detailed recommendations, the more important of which related to a system of annual budgeting for working capital requirements of SSI borrowers, computerisation of information on SSI borrowers, creation of an 'Ombudsman' type of authority within the banks to look into the grievances of SSI borrowers, revitalisation of the state-level forums and setting-up district level forums to oversee and monitor credit to SSIs, particularly units that came within the norms of the single-window scheme of SIDBI.

The committee recommended a modified definition of a sick SSI unit, the creation of cells within the banks at regional centres to deal with sick SSIs, the constitution of state-level inter-institutional committees (SLIIC) and a role for a district counterpart of SLIIC in monitoring and overseeing the bank's progress in the quick determination of the viability of sick units.

Other recommendations included: (i) indexing the value of investment in plant and machinery of units to ensure uniform application of the definition of SSI; (ii) moderating the interest rates charged to tiny units; (iii) reducing the service/collection charges and overdue interest charged by bank on the bills of their SSI clientele; (iv) abolishing the system of levying the DICGC credit guarantee fee separately for SSI borrowers; (v) creating a separate modernisation fund for SSIs; and (vi) setting-up factoring organisations in all parts of the country and allowing the private sector to enter this field. The implementation of the recommendations of the committee on financing SSI was monitored by the Reserve Bank by conducting sample studies. Besides, banks themselves were carrying out special studies on an annual basis and the Reserve Bank was kept informed of the findings and the steps taken to rectify the deficiencies in credit disbursal to SSIs.

MICRO-FINANCE MOVEMENT

In the past, several deficiencies had crept into the formal rural credit system, *viz.*, poor recovery of loans, high transaction costs in dealing with small borrowers at frequent intervals and the burden of subsidised interest rates. These had weakened the rural credit delivery system. Despite the Government's efforts to reach millions of poor through a variety of programmes for the priority sector, the reach of these programmes to the poorest of the poor was limited. Thus began the search for an alternative delivery mechanism that would meet the requirements of the poor, especially the women members of such households. It was then that the idea of organising SHGs began to take shape. An SHG is a group of about

10–20 persons from a homogeneous class (affinity group) who come together to address common problems. They collect voluntary savings on a regular basis and use the pooled resources to make small interest-bearing loans to their members. The process helps them imbibe the essentials of financial intermediation, including prioritisation of needs, setting terms and conditions and keeping accounts.[7]

The system of micro-finance offered as a viable alternative, following the example of the success of *grameen* banks created by Prof Muhammad Yunus in Bangladesh. Explaining the rationale behind the policy decision, Dr C. Rangarajan,[8] subsequently illustrated that despite the expansion of the organised banking system deep into rural areas, a very large number of the poor continued to remain outside the fold of the formal banking system. The extant banking policies, systems and procedures were not suited to enable the poor to approach the formal system.

The beginning of the micro-finance movement in India can be traced to the SHG- bank linkage programme, which was started as a pilot project in 1992 by NABARD in co-ordination with the Reserve Bank. The Reserve Bank provided policy support by advising banks to actively participate in the programme. In 1994, the Reserve Bank constituted a working group on NGOs and SHGs. On the recommendations of the group, the Bank advised that the financing of SHGs by banks would be reckoned as part of their lending to weaker sections, and that such lending should be reviewed by banks as well as the state-level bankers' committee (SLBC) at regular intervals. As a follow-up to the recommendations of another working group constituted by NABARD, the Reserve Bank took a series of measures in April 1996 to give a thrust to microfinance-based lending.

WORKING GROUP ON NGOs AND SHGs

The working group on NGOs and SHGs set up by the Reserve Bank in 1994 put forward a set of wide-ranging recommendations on SHGs and bank linkage as a potential innovation in the area of banking with the poor. In widening the credit delivery system, banks could extend credit to SHGs, NGOs and other intermediaries. Such organisations, in turn, could help identify and meet the genuine credit requirements of the rural

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7. Chakrabarty, K.C. (2011). "Technology and the Financial Inclusion Imperative in India", in Sameer Kochhar (ed.), *Growth and Finance: Essays in Honour of C. Rangarajan*. New Delhi: Academic Foundation.

8. Rangarajan, C. (2005). "Microfinance: The Road Ahead". Inaugural Address at *The International Conference on Microfinance in India* organised by CARE. New Delhi. April 12.

poor. Attempts at rationalising the system of credit delivery had to be supplemented by a revamped system of credit recovery without which the rural credit system could not be sustained. While improving the recovery mechanisms, commercial banks, RRBs and co-operatives could consider appointing 'recovery facilitators', drawn locally, to help improve loan collections.

A systematic reform of rural credit had to aim at innovation and development consistent with the principles of efficiency and viability. Several factors continued to impede the ongoing efforts aimed at creating an efficient and viable rural credit delivery system. Overdues remained high. As a consequence, recycling of credit became a major casualty and the losers were prospective borrowers. Institutional reach to small and marginal farmers was not on the expected lines. There were complaints of inadequate and untimely credit availability on one hand and misutilisation of credit and defaults on the other. Any programme of rural credit reform needed an emphasis on: (i) institutional strengthening; (ii) appropriate changes in the policy framework; and (iii) mobilisation of larger financial resources. The existing multi-agency institutional structure had to continue, given the different stages of development of the institutions across the country in various states.

The three agencies involved in rural credit — rural branches of commercial banks, RRBs and the co-operative credit system — had, therefore, to be streamlined and strengthened so that they could become efficient disbursers and purveyors of credit. The Reserve Bank advised commercial banks to formulate specific plans for increasing their deployment in the agricultural sector and to ensure that lending to agriculture was considerably stepped up. The modifications in the SAA helped the banks in this direction. To ensure adequate and timely flow of rural credit, as also to meet the composite needs of farmers, the Reserve Bank allowed banks to extend cash credit facilities to farmers with irrigation resources for farming and to other farmers for undertaking non-farm/allied activities.

Banks were also asked to help farmers diversify into new areas, such as horticulture and floriculture, where the demand was more elastic than that of food grains. The early processing of the recommendations made by the expert committee on the IRDP, especially those dealing with issues such as procedures for selection of beneficiaries, mode of subsidy payment and effective recovery mechanisms, helped to bring about much needed change in the approach of the banks while lending under such programmes.

The Reserve Bank constituted another working group (Chairman: Shri S.K. Kalia) in 1996 to study the functioning of SHGs and NGOs with a view to expanding their activities and deepening their role in the rural sector. The recommendations of the working group were accepted by the Reserve Bank and the banks were advised to implement these as soon as possible.

IMPACT OF MICRO-FINANCE

Given that the poor, both in the rural and urban areas, did not have the necessary capabilities to approach and negotiate with organised credit institutions; the linking of formal credit institutions with the rural and urban poor through intermediaries, such as NGOs, was thought of as an alternative mechanism to meet the credit needs of the poor. The establishment of SHGs could be traced to the existence of one or more common problems around which the consciousness of the rural poor was built. The group, thus, was normally a response to a perceived need, besides being centred around specific productive activities. These groups also promoted savings among their members and used pooled resources to meet the needs of their constituents. It was felt that initiating and monitoring the credit programmes could be made more effective and less costly if banks made attempts to organise the poor into SHGs, whereby peer pressure could be used to ensure proper utilisation of credit and prompt repayment of loans. Apart from the powerful influence of peer pressure, the groups could also contribute towards improving the quality of lending by offering loans in a prompt and simple manner, ensuring extending only need-based loans and keeping the loan size within the repaying capacity of the borrowers.

The main advantage to the banks of the link with SHGs and NGOs was externalisation of a part of the work items of the credit cycle, *viz.*, assessment of credit needs, appraisal, disbursal, supervision and repayment, reduction in the formal paper work involved and a consequent reduction in the transaction costs. Improvements in recoveries led to wider coverage of the target group. A larger mobilisation of small savings was equally advantageous. The link was also useful to the groups due to access to larger quantum of resources compared with their meagre corpus generated through thrift, availability of better technology and skill upgrading through different schemes of the banking sector.

The role of voluntary organisations was somewhat distinct from SHGs. The NGOs had a role in organising the rural poor into SHGs and in

ensuring their proper functioning. In the Indian context, NGOs focused on their activities in the areas of education and health and, to some extent, development in general. Their role in providing an effective link between organised credit disbursing agencies and those who had the need and were eligible to obtain credit from such institutions had been minimal. A fairly large number of programmes were formulated, which aimed at providing credit to the poor. Their effective utilisation by eligible borrowers could have been enhanced had the NGOs gained the necessary institutional strength to forge linkages with the formal credit agencies and reached out to the poor for their credit needs. Their mediatory role could go beyond facilitating securing credit and monitoring its effective use and recovery. The improvement in the recovery performance increased the credibility of these poverty alleviation programmes and resulted in effective recycling of credit.

Studies and surveys suggested that NGOs had a comparative advantage in making transfers to the poor because they had local contacts and consequently better information about the poor. Further, they could help reduce the leakage in delivery of benefits that resulted from the inefficiencies of the formal financial institutions. Additionally, the group dynamics and peer pressure could bring in excellent recovery from the members of SHGs.

THE RESERVE BANK, NABARD AND RURAL FINANCE

The resources of NABARD consisted mainly of NRC funds, capital, reserves, deposits and borrowings. In addition, the Government provided funds received from the World Bank and other external agencies under various credit projects supported by these agencies. With the contribution of ₹ 10 crore each from the Government and the Reserve Bank, the paid-up capital of NABARD increased from ₹ 100 crore to ₹ 120 crore during 1993–94. NABARD mobilised ₹ 78 crore through market borrowings by the issue of the ‘thirteenth series of NABARD bonds’ (at par) that had a maturity period of 10 years and carried an interest rate of 13.5 per cent per annum. NABARD revised the rates of interest on its refinance with effect from March 1, 1994, which would be applicable to all fresh lending/disbursements by banks. The interest rates prescribed for refinance were mostly specific rather than linked to the Bank Rate.

NABARD continued its efforts to identify thrust areas and priorities for credit support. The major thrust areas identified, *inter alia*, were minor irrigation, plantation and horticulture, post-harvest technology, tissue

culture, export-oriented projects, agro-processing, dry land farming, wasteland development, forestry, fisheries and non-farm activities. For remunerative development of the resources of state co-operative banks and CCBs, NABARD decided to liberalise the norms for financing individuals by the banks. The facilities extended for the purpose included: (i) raising the maximum ceiling for loans against gold ornaments/jewellery per individual to ₹ 40,000; (ii) raising the ceiling for loans for purchase of consumer durables from ₹ 25,000 to ₹ 30,000; and (iii) sanction of cash credit facility to businessmen/traders against a collateral, pledge or hypothecation of stock-in-trade up to ₹ 2 lakh.

In terms of section 46 of the Reserve Bank of India (RBI) Act, 1934, the Bank was required to contribute every year such sums of money as it might consider necessary and feasible to the NRC (LTO) fund and NRC (stabilisation) [S] fund, which were maintained by NABARD. Accordingly, the Bank was contributing to the above funds every year before passing on the net surplus to the Government. These contributions were by way of grants to augment the resources of NABARD. The Reserve Bank's contribution to these funds at ₹ 4,780 crore formed 64.0 per cent of the total amount of the funds at ₹ 7,415 crore. During the years 1989–90, 1990–91 and 1991–92, the Reserve Bank contributed ₹ 340 crore, ₹ 385 crore and ₹ 420 crore, respectively, to these funds.

The Union Finance Minister, in his budget speech for 1992–93, announced that the Reserve Bank would transfer a larger share of its profits to the Union Government. In pursuance thereof, the Bank took a policy decision to discontinue appropriation of large sums from its profits for credit to the four statutory funds before transferring the surplus to the Government.[9] NABARD was accordingly advised that no contribution would be made to the above two funds from 1992–93. To ensure adequate availability of funds, NABARD was advised to take recourse to the market, and issue bonds akin to public sector bonds. The net effect was that the funds, which were being made available to NABARD free of cost by the Reserve Bank, were substituted by high-cost funds. NABARD was, therefore, with the restricted margin available to it, not in a position to continue to lend funds at low rates of interest and an upward revision could only be done in unavoidable circumstances.

During the statutory audit of the Reserve Bank for the year 1992–93, the auditors observed that according to section 46 A of the RBI, Act, 1934 it

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9. For details refer to chapter 17: Reforms in Banking and Financial Institutions.

was a binding on the Bank to contribute to the two funds maintained every year, unless these provisions were suitably amended. The Legal Department opined that section 46 made it obligatory on part of the Reserve Bank to contribute to the NRC (LTO) and NRC [S] funds such sums of money as it considered necessary and feasible every year. Consequently, the Bank contributed a sum of ₹ 1 crore to each of these two funds from the surplus for the year 1992–93, pending necessary amendments to the section of the Act to give effect to the decision taken to discontinue such a practice.

As enunciated in the Union Budget for 1992–93:[10]

> …the entire surplus profits of RBI were required to be passed on to Government of India. As such RBI did not contribute to National Rural Credit (LTO) Fund during the year. Considering the need for a substantial step up in the private capital formation in agriculture during the Eighth plan period to put it on a higher growth path, the flow of credit to agriculture and rural development from institutional sources have to be suitably expanded. In case the resources of NABARD are not suitably augmented, it may not be possible for it to meet the refinance commitment. Raising resources at market rates and providing refinance would not be a viable proposition for NABARD. There is therefore need for continued support to its resources through contribution from RBI to its NRC (LTO) fund.

No sooner did the Reserve Bank realise that it was violating the provisions of section 46(A) of the RBI Act, 1934 and section 42(I) of the NABARD Act, 1981, which made it mandatory for the Reserve Bank to contribute to this fund, the Bank considered various options in this regard. The alternative of adhering to the provisions of the Acts in letter, while not in spirit, was found by contributing a token amount of ₹ 1 crore every year. Had the Reserve Bank continued with the usual contribution, which worked out to an average of 31.14 per cent of its profits, the total transfers to the NRC (LTO) fund would have been much higher. To all requests for continuation and enhancement of the GLC, the Reserve Bank's stand was that: "since GLC is created money, it is by nature inflationary and therefore has to be discouraged." The stance of the Reserve Bank was a reflection of its association with monetary orthodoxy. Unless the economic policy contours of the country were freed from these orthodoxies, neither

10. NABARD, *Annual Report, 1992–93.*

of these institutions could appreciate the need for increased credit flow to agriculture by supporting the refinance operations of NABARD through regular transfers from Reserve Bank profits.[11]

In terms of the government policy, an amendment to the provisions of section 46 of the RBI Act, 1934 to make them 'enabling' rather than 'mandatory' provisions was carried out in 1994. In 1993–94, NABARD sanctioned total credit limits aggregating ₹ 557 crore for short-term purposes, which included credit limits for the SAO aggregating ₹ 396 crore sanctioned to 132 RRBs. Medium-term credit limits (non-schematic) were sanctioned to 88 RRBs for an aggregate amount of ₹ 58 crore as against ₹ 54 crore to 102 RRBs in the previous year. The rebate on income tax on the interest income of rural advances of commercial banks and the treatment of net funds provided by sponsor banks to RRBs as priority sector lending would also help improve the flow of rural lending. RRBs continued to avail of long-term refinance from NABARD. Up to March 1994, 5,547 schemes involving NABARD's commitment of ₹ 2,962 crore were sanctioned to RRBs and drawals against this commitment amounted to ₹ 2,672 crore as against 5,146 schemes involving NABARD's commitments of ₹ 2,577 crore and disbursements of ₹ 2,314 crore up to March 1993. A number of measures were taken to revitalise the co-operative banks.

For long-term improvement in rural credit, the Union Budget for 1994–95 provided ₹ 100 crore to augment the share capital of NABARD and a similar contribution would come from the Reserve Bank so that NABARD could play a leader in strengthening the system of rural credit. For the year 1995–96, the Reserve Bank sanctioned in June 1995 an aggregate limit of ₹ 4,950 crore, which was enhanced to ₹ 5,250 crore in January 1996.

Prudential accounting, guidelines of income recognition, asset classification, provisioning and other related matters were extended to NABARD in March 1996 with certain modifications, keeping in view the special nature of its operations. These guidelines were extended to RRBs, state co-operative banks and CCBs from the year 1996–97.

During 1995–96, the Reserve Bank enhanced its GLC (I and II) for NABARD by ₹ 300 crore to ₹ 5,250 crore and further to ₹ 5,500 crore in 1996–97. The share capital of NABARD was also raised during 1995–96 by ₹ 170 crore to ₹ 500 crore, with equal contributions from the Reserve Bank

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11. Satish, P. (2010). "Funds for NABARD", *Economic and Political Weekly*. September 25

and the Government. As part of a plan to quadruple the share capital of NABARD from the existing level of ₹ 500 crore to ₹ 2,000 crore in the next five years, the Union Budget for 1996–97 proposed to double the share capital of NABARD to ₹ 1,000 crore in 1996–97 with a contribution of ₹ 400 crore from the Reserve Bank and ₹ 100 crore from the Government. To ensure that NABARD would adhere to the same financial discipline as banks and other term lending institutions, the prudential accounting standards as also the capital adequacy requirement of 8.0 per cent were extended to NABARD in March 1996 for implementation in phases.

RURAL INFRASTRUCTURAL DEVELOPMENT FUND

Many banks, both in the public and private sectors, were not able to meet their priority sector targets. Therefore, public and private sector banks with shortfalls in lending to the priority sector or to agriculture were required to contribute specified allocations to the RIDF. The Finance Minister announced in his budget speech on March 15, 1995 that a new RIDF would be established in NABARD to give loans to state governments and state-owned corporations for quick completion of ongoing projects on medium and minor irrigation, soil conservation, watershed management and other forms of rural infrastructure. The Union Budget for 1995–96, proposed that a new RIDF with a corpus of ₹ 2,000 crore would be established in NABARD. All SCBs (excluding RRBs and new private sector banks) would contribute to the RIDF an amount equivalent to the shortfall in achieving the priority sector sub-target of 18.0 per cent for agricultural lending, subject to a maximum of 1.5 per cent of net bank credit. The rate of interest paid by NABARD on the outstanding deposits placed by banks would be a floating rate equivalent to one-half of one percentage point above the maximum permissible rate on term deposits. The contribution to the fund made by banks would be reckoned as their indirect agricultural lending under the priority sector. The loans to be given by NABARD to the state governments/local bodies from the fund would be project-specific for a period up to 5 years. The concerned state governments would provide a government guarantee in respect of repayment of principal and payment of interest thereon. Further, state governments would execute an irrevocable letter of authority in favour of the Reserve Bank, authorising it to debit the state government account if the payment due under the scheme was made on the due date.

The first RIDF was established with NABARD in 1995–96 to provide loans to state governments for financing rural infrastructure projects. The

RIDF became the main instrument to channelise bank funds for financing rural infrastructure. By 1998, four tranches of RIDF were set, with a total corpus of ₹ 10,000 crore. The total amount disbursed from the four tranches of the RIDF aggregated ₹ 9,095 crore.

RELATED DEVELOPMENTS

Commercial banks were allowed in October 1994 to consider merit proposals for term loans/finance in the form of lines of credit to SIDCs and SFCs for extending loans to SSI units. Such loans to SSI units would be treated as part of priority sector lending. As a follow-up to the seven-point action plan announced in the Union Budget for 1995–96 to improve the flow of credit to the SSI sector, commercial banks were advised to set up 100 dedicated specialised branches during 1995–96 to serve the needs of 85 identified districts with a high concentration of SSI units.

The guidelines for setting-up banks in the private sector stipulated that they had to observe priority sector lending target as applicable to other commercial banks at 40.0 per cent. The new private sector banks were permitted to substitute the agricultural lending stipulation of 18.0 per cent by contributing partly or wholly to the deposit of NABARD and/or the SIDBI for a period of three years from their inception. The interest rates payable on these deposits would be as stipulated by the Reserve Bank.

The rate of interest payable by SIDBI on deposits received from foreign banks to make good the shortfall in achievement of the overall priority sector lending target of 32.0 per cent as also the sub-targets of 10.0 per cent each in respect of SSIs and export credit were revised downwards in September 1994 to 8.0 per cent per annum.

The Union Budget 1995–96 took the initiative to increase the flow of credit to rural and SSIs. The contribution by commercial banks to such schemes, *e.g.*, RIDF, loans to the khadi and village industries commission (KVIC), loans to weavers in the handloom sector and primary weavers co-operative societies (PWCS) and the lines of credit to SFCs for extending loans to SSIs would be reckoned as part of their priority sector lending. It was decided that the entire amount of refinance rather than the net funds hitherto provided by commercial banks to their sponsored RRBs would be reckoned as priority sector lending of the sponsor banks. Further, 50.0 per cent and 40.0 per cent of such refinance could be reckoned as indirect agricultural lending and advance to weaker sections, respectively.

In view of the crucial importance of non-farm activities, the Union Budget for 1995–96 proposed a scheme under which the banking system

would provide ₹ 1,000 crore on a consortium basis to the KVIC to enable it to extend finance to viable *khadi* and village industrial units either directly or through state-level khadi and village industries boards (KVIBs). Accordingly, a consortium of select PSBs was formed, led by the State Bank of India (SBI), to provide credit to the KVIC. Banks that had not achieved the priority sector lending target of 40.0 per cent even after allocation of their contribution to the RIDF were included in the consortium. These loans, which would be provided at 1.5 per cent below the average PLR of five major banks in the consortium, would carry a government guarantee and would be reckoned as indirect lending of the concerned banks to SSIs under the priority sector. As proposed in the Union Budget for 1995–96, a consortium of 20 PSBs provided a sum of ₹ 325 crore as at end-June 1996 to the KVIC for lending to viable *khadi* and village industrial units. With the extension of NABARD's refinance facility to commercial banks, the latter were advised to provide working capital finance to the PWCS.

BANK FINANCE FOR PRIMARY WEAVERS CO-OPERATIVE SOCIETIES

A scheme announced in the Union Budget for 1995–96 envisaged increasing the flow of credit to the large number of weavers employed in the handloom sector. The refinance available from NABARD to the PWCS would be extended to commercial banks in addition to being routed through the co-operative sector, provided the societies to be financed had a satisfactory working record and were not indebted to the CCBs. NABARD would provide a line of credit to commercial banks for the production-cum-marketing activities of PWCS at 9.5 per cent per annum, which would be made available to the handloom co-operative at the same rate, provided that a subsidy of 2.5 per cent was received from the state government. The advances made by commercial banks to handloom co-operatives would be reckoned as indirect finance to the SSI sector and would form part of the banks' priority sector lending.

REGIONAL RURAL BANKS

With the introduction of financial sector reforms in 1991–92, the commercial viability of RRBs, which were an important element in the rural credit delivery system, emerged as the most crucial factor in deciding their role in the emerging economic scenario. The financial health of RRBs had turned weak due to limited business opportunities with little scope for expansion/diversification, smaller size of their loans with higher exposure

to risk-prone advances and their professional inefficiency in financial deployment. RRBs had high credit-deposit ratios owing to low reserve requirements and liberal refinancing facilities.

The viability of RRBs had been under serious strain for quite some time as they extended credit only to weaker sections and consequently the return available to them was unsustainably low. Their loans were more risk-prone and recoveries somewhat lower than those of commercial banks. The average deposit per branch of RRBs was a fraction of the average for rural branches of commercial banks. RRBs were conceived of as low-cost institutions. However, the cost differentials between RRBs and commercial banks were narrowing over time.

A number of policy initiatives, therefore, were taken to improve the viability of RRBs. Considering that most of RRBs were weak and were incurring losses and that their target groups comprised weaker sections, the Reserve Bank exempted all RRBs from the proviso to sub-sections 1 and 1(A) of section 42 of the RBI Act, 1934 for a period of two years, up to December 31, 1994, allowing them to maintain the CRR at 3.0 per cent of their net demand and time liabilities (NDTL). Later, on December 22, 1993, the Reserve Bank, in consultation with the Government and NABARD, announced a package of measures for RRBs with a view to giving them greater freedom to rationalise their existing branch network and bring in operational efficiency. These included: (i) freeing 70 RRBs whose disbursals were below ₹ 2 crore during 1992–93 from their service area obligations, while permitting other RRBs to extend financial assistance in their entire command areas provided they met their service area obligations; (ii) increasing their non-target group financing from 40.0 per cent to 60.0 per cent of fresh loans; (iii) allowing RRBs to relocate the existing loss-making branches at new places like *mandis*/agricultural produce centres at block/district headquarters; (iv) giving them the freedom to open extension counters; and (v) upgrading and deepening the range of their activities to cover non-fund business. Besides, the Government took up the task of transforming the weak RRBs into financially viable and effective instruments of decentralised banking.

Of the 196 RRBs, the number of loss-making RRBs stood at 172 as at end-March 1993. Many had completely wiped out their equity and reserves, and in some cases the losses had eroded the deposit base. As this situation was unsustainable, there was a need for long-term structural measures. The 70 RRBs that had been freed from the SAA and were allowed to relocate

their loss-making branches to specified centres within the same block were permitted to convert the loss-making branches into satellite/mobile offices and also consider mergers, wherever possible. These facilities were also extended to RRBs that adhered to the SAA, which, however, had to ensure that the conversions did not impair their continued performance of SAA obligations.

The Union Budget for 1994–95 announced several measures aimed at restructuring the rural credit delivery system and improving the credit flow to the agricultural sector. An important step taken in this direction was to resuscitate RRBs through comprehensive restructuring, which included cleaning up their balance sheets and infusing fresh capital. A committee was appointed under the chairmanship of Shri M.C. Bhandari, chief general manager, NABARD to identify RRBs for restructuring. The committee submitted its interim report identifying 50 RRBs based on their financial strength and also considering their regional representation. The Government accepted the recommendations of the committee to take up 49 of the 50 RRBs identified for restructuring. Forty-eight RRBs had already entered into an agreement with its respective sponsor banks. The Government contributed ₹ 150 crore as its share of 50.0 per cent for this purpose. Another 50 RRBs were taken up for restructuring during 1995–96, for which a sum of ₹ 300 crore was provided in the Union Budget for 1995–96.

The recipient RRBs for their part had to fulfil within a time frame certain performance obligations and commitments on a variety of indicators, including growth of deposits, a mix of various types of deposits, disbursement to target and non-target groups, investment in SLR and non-SLR categories, recovery targets, staff productivity, cost of funds, return on resources, improvement in spread and breakeven level. As part of the overall package of measures designed to improve the operational efficiency and profitability of RRBs, the Reserve Bank, in line with the recommendations of the Bhandari Committee, permitted RRBs in January 1995 to invest their non-SLR funds in specified investment avenues such as Unit Trust of India (UTI) listed schemes and fixed deposits of profit-making term lending institutions, or 25.0 per cent of the aggregate deposits as at the end of the preceding year, whichever was higher. The sponsor banks would continue to aid and advise RRBs regarding the choice of investment avenues until they developed the requisite technical expertise in funds management. Again in January 1995, RRBs were allowed to park part of their non-SLR funds in the credit portfolios of their sponsor banks

through non-risk sharing participation certificates issued by the latter on mutually agreed terms and conditions. Such investments through the credit route were subject to a maximum of 15.0 per cent of fresh lending during the year and were to be reckoned within the ceiling fixed for non-target group lending.

In July 1995, the Reserve Bank constituted an expert group (Chairman: Shri N.K. Thingalaya) to examine the major policy issues concerning the managerial and financial restructuring of RRBs taken up during 1994–95 and continued in 1995–96, and to monitor the progress of this exercise. The group examined the progress of restructuring and suggested supplementary policy measures on an on-going basis.

Sixty-eight more RRBs were identified for restructuring in the second phase by a committee set up by NABARD in its report in December 1995 (Chairman: Dr K. Basu) in addition to two RRBs identified by the Government.

To widen the investment options of RRBs, the recommendations of the working group (Chairman: Shri K.K. Misra) on funds management in RRBs were considered and with a view to broad base their range of activities, RRBs were allowed to extend housing loans, subject to certain conditions.

The credit-deposit ratio of RRBs continued to decline from 67.0 per cent as at end-March 1993 to 56.0 per cent as at end-March 1995. Overdues as a percentage to advances outstanding, however, declined from 34.9 per cent as at end-March 1994 to 29.7 per cent in March 1995

In order to impart durability to the restructuring process, RRBs were advised to adopt income recognition, asset classification and exposure norms from 1995–96 and provisioning norms from 1996–97. As part of the restructuring process of RRBs, an amount of ₹ 200 crore was provided in the Union Budget for 1996–97 and a further allocation of ₹ 270 crore was made in the Union Budget for 1997–98. RRBs were permitted to open new branches that would be manned by redeploying their employees at centres that had business potential in the areas of their operation. In order to strengthen the capital base of rural financial institutions, a sum of ₹ 400 crore was released by the Government for recapitalisation of 90 RRBs in 1997–98, of which 15 were included for the first time. The Union Budget for 1998–99 earmarked an amount of ₹ 265 crore for further recapitalisation of RRBs.

The rebate on income tax on the interest income of rural advances of commercial banks and the treatment of net funds provided by sponsor

banks to RRBs as priority sector lending also helped improve the flow of rural lending. These measures had the desired impact on the financial performance of RRBs. The number of profit-making RRBs increased sharply to 109 during 1997–98. RRBs, as a group, also earned a net profit of ₹ 43 crore during 1997–98 as against net losses of ₹ 589 crore incurred in 1996–97.

REVAMPING CO-OPERATIVE CREDIT INSTITUTIONS

Co-operative credit institutions accounted for the major share of total direct institutional credit for agriculture and allied activities. Loans extended by RRBs formed a relatively small proportion of the total rural credit. Commercial banks accounted for the rest, but a little over one-half of these loans were of a short-term nature. In response to the changing pattern of rural demand for credit, banks had been expanding their advances to allied activities at a more rapid pace than that for agriculture. The Reserve Bank facilitated the credit flow to agriculture and the rural segment by allowing flexibility in the interest rate and bringing in changes in the fund allocation methods of banks.

In general, the co-operative credit system suffered from a number of problems, such as: (i) excessive reliance on funds from higher-level structures; (ii) undue state control; (iii) poor deposit mobilisation; and (iv) poor recovery of loans. The major flaw of the co-operative system lay in the weakness of the base-level institutions, mainly because they neglected their basic responsibility of mobilising deposits. In the case of RRBs, the problem areas included low interest rates, high operating costs in handling small loans and loans to weaker sections in backward regions, and high salary structure, which resulted in very low and even negative margins.

To give greater freedom to financially strong and well-managed urban co-operative banks (UCBs), which fulfilled prescribed norms, were permitted to open branches at centres of their choice without having to obtain prior approval of the Reserve Bank. UCBs were permitted to extend their area of operation to rural centres even beyond 10 km from the boundaries of semi-urban/urban centres, subject to the condition that they provided financial assistance only for non-agricultural productive activities. Well-managed and financially strong UCBs with deposits above ₹ 50 crore that satisfied certain norms were permitted to extend the area of operation even beyond the state of their registration. In order to enable UCBs to freely extend their area of operation within the district of their registration, prior approval from the Reserve Bank was dispensed with,

subject to their obtaining approval from the Registrar of Co-operative Societies. UCBs were, however, required to seek the prior approval of the Reserve Bank to extend their area of operation beyond the district of registration. One UCB was deleted from the list of scheduled UCBs when it was converted into a commercial bank, while five UCBs were included in the second schedule of the RBI Act, 1934, taking the total number of scheduled UCBs to 18.

Up to May 1995 the Reserve Bank issued licences to two state co-operative banks and 14 district co-operative banks under section 22 of the BR (as applicable to co-operative banks) Act, 1949, taking the total number of licensed state co-operative banks and district co-operative banks to 12 and 52, respectively. Licences were also issued to five state co-operative banks under section 23 of the BR (as applicable to co-operative banks) Act, 1949 to open five branches. With the granting of scheduled status to the Goa State Co-operative Bank Ltd by the Reserve Bank with effect from December 15, 1994, the total number of scheduled state co-operative banks rose to 15.

To re-orient the co-operative banking operations along commercial lines with cost effectiveness, the state co-operative banks, SLDBs, CCBs, and primary land development banks (PLDBs) were advised to prepare institution-specific development action plans and state action plans (SAPs).

A major shortcoming of the co-operative credit structure was the poor recovery rate of loans. Loan overdues as a percentage of loan demand was 53.7 per cent in 1992–93 for SLDBs, followed by 42.9 per cent for CCBs, 42.0 per cent for primary agricultural credit co-operative societies (PACS) and 16.2 per cent for state co-operative banks. The overdue rates for co-operatives in 1992–93 showed no improvement over the previous year in general, except for state co-operative banks and SLDBs

Some of the credit policy measures directed towards commercial banks such as those relating to loans and advances, credit to individuals against shares and debentures/bonds and interest rates on deposits and advances were also made applicable to UCBs with suitable modifications. The UCBs were allowed to offer at their discretion an additional rate interest not exceeding one-half of one percentage point per annum on term deposits of 46 days and above and one percentage point per annum on savings deposits over the rates prescribed for SCBs. The UCBs were allowed to accept term deposits for periods exceeding 10 years. Interest rates on term loans for three years and above were reduced by 0.5 per cent

to 1.0 per cent per annum with effect from March 1, 1994. Further, in line with commercial banks, the PLR for advances above ₹ 2 lakh was made effective from October 18, 1994. For the first time, scheduled UCBs were considered for investing their surplus funds in certificates of deposit (CDs) and commercial paper (CP) with a credit rating of P1 or A1 from CRISIL/ICRA.[12] Accordingly, during 1993–94, four of the scheduled UCBs were permitted to place their surplus funds in CP and six UCBs in CDs issued by SCBs and FIs that were authorised by the Reserve Bank.

While granting advances against units of mutual funds, UCBs were advised to follow broad guidelines on advances against shares and debentures and, in addition, ensure that: (i) units against which advances were made were listed on stock exchanges; (ii) the minimum lock-in period was over; (iii) the quantum of advance was linked to the need of the borrower as also the net asset value or market value, whichever was lower (not face value); and (iv) the prescribed margins were to be maintained and the advances were purpose-oriented, subject to the overall ceiling on borrowings by equipment-leasing and hire-purchase companies. The UCBs were allowed to lend to companies in consortium with commercial banks up to 4.0 per cent of the net owned funds (NOFs) of the individual company. In line with instructions to commercial banks, the UCBs were advised that advances secured against term deposits, national savings certificates (NSCs), Indira vikas patras and kisan vikas patras were exempt from the provisioning requirements. Further, the UCBs were permitted to take into account the amount of interest on the above types of advances on actual basis, provided that an adequate margin was available in the account.

With effect from May 16, 1994 the Reserve Bank permitted state co-operative banks/CCBs, (on a case-by-case basis) and all UCBs to invest 10.0 per cent of their deposits in public sector undertaking (PSU) bonds for deploying their surplus funds profitably, subject to certain conditions or safety measures, *viz.*: (i) the investments had already been made in PSU bonds and fresh investments should not exceed 10.0 per cent of their deposits; (ii) permission should be obtained from the concerned Registrar of Co-operative Societies; and (iii) instructions regarding investment policy and dealings in securities transactions should be complied with. Scheduled state co-operative banks were exempt from the provisions of

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12. CRISIL: Credit Rating Information Services of India Ltd; ICRA: Investment Information and Credit Rating Agency of India Ltd.

the proviso to sub-sections (1) and (1A) of section 42 of the RBI Act, 1934 for a further period of two years up to December 31, 1996, whereby the cash reserves to be maintained by them would continue to be 3.0 per cent of their demand and time liabilities.

The Government proposed in the Union Budget for 1994–95 to initiate a series of measures for strengthening the co-operative structure. As part of this process, NABARD entered into MoU with state/district/CCBs and the concerned state governments to implement state-specific district action plans (DAPs) to revamp these banks and improve their viability. It also issued guidelines to co-operative banks for preparing the plans and actively assisted them in the implementation.

At the end of March 1995, NABARD signed such agreements with 17 state co-operative banks, and 13 SLDBs. The agreement envisaged, on the part of these banks, time-bound performance of specific actions for making the co-operative banks viable and strong.

NABARD extended support and guidance to the co-operatives in formulating their MoU, and made elaborate arrangements to monitor their implementation. The MoU contained various measures to be taken by banks and the concerned state governments in the areas of management, organisation, recovery, monitoring and the business plan over five-year period. The policy framework relating to rural credit was made conducive to maintain the economic viability of credit institutions. A major change brought about was total deregulation of interest rates in relation to co-operative banks. Co-operative credit institutions could access resources competitively and lend at remunerative rates of interest. Greater emphasis was placed on adequate and timely availability of credit from institutional sources than on subsidised rates of interest, which resulted in making the institutions viable.

It is relevant, in this context, to mention that periodic introduction of the schemes that waived the payment of principal or interest or both, damaged the loan recovery culture and credit discipline. While some of these schemes showed increased recovery in the year in which they were introduced, over time they adversely affected the borrowers' attitude towards repayment and, resultantly the practice of timely repayment suffered.

The process of signing MoU to revamp the co-operative credit structure, as discussed above, continued during 1995–96. In all, 28 state co-operative banks and 20 SLDBs were covered. MoU between NABARD, state co-operative banks and district central co-operative banks (DCCBs)

were signed for 358 of the 363 DCCBs. To prepare the profit and loss account and balance sheet reflecting the bank's actual financial health, a proper system for recognition of income, classification of assets, and provisioning on a prudential basis was deemed as necessary. The feasibility of making income recognition and asset classification norms applicable to state co-operative banks/CCBs was examined by the Reserve Bank in consultation with NABARD and, accordingly, guidelines on prudential norms were issued to these banks for adoption effective March 31, 1997.

CO-OPERATIVE DEVELOPMENT FUND

NABARD set up the co-operative development fund (CDF) in 1994 to provide financial assistance through grants/loans to co-operative banks for human resource development with suitable training inputs, to build better management information systems (MIS) and infrastructure facilities for PACS to mobilise deposits.

COMMERCIAL BANKS

Undoubtedly, the presence of commercial banks expanded remarkably in the rural areas during the 1980s and they emerged as the leading agency for deposit mobilisation and lending to the rural sector. Apart from financing agriculture and village industries, they played a critical role in implementing poverty alleviation programmes, such as the IRDP. Despite these achievements, several deficiencies persisted in their operations. Their record in recovery of loans was only slightly better than that of co-operatives. The rural orientation of their staff, although improved over time, was often below desirable levels. Considering the high administrative and risk costs, the price of rural credit was inadequate. While cross-subsidisation from other borrowers such as from industry borrowers helped to some extent, it could not be stretched beyond a point.

The growth of rural commercial banking during the period 1989–1997 suffered in terms of number of bank offices, credit outstanding and credit-deposit ratio. During the period 1990 to 1996, the number of SCB bank offices declined from 34,867 to 32,981. The credit outstanding increased from about ₹ 17,000 crore to ₹ 29,000 crore, but its share in the total came down from 14.2 per cent to 11.0 per cent during the period. Rural deposits escalated from around ₹ 28,600 crore to ₹ 61,200 crore, but the credit-deposit ratio dropped from about 60.0 per cent to 47.0 per cent. The share of priority sector advances to the total also came down from 40.7 per

cent to 32.8 per cent.[13] One of the main reasons for such developments appeared to be the risk aversion that developed due to the very low recovery performance.[14]

DEBT RELIEF

In his budget speech for 1989–90, the Finance Minister observed:

> Credit is a major input for agricultural production. In order to increase the flow of credit to agriculture, the target for direct finance to agriculture by Public Sector banks, which was raised from 16 per cent to 17 per cent of their total outstanding advances is being further raised to 18 per cent to be achieved by the end of 1989–90. With this change the total credit to be made available to agriculture by commercial banks, Regional Rural Banks and Co-operative banks will increase by over ₹ 4,000 crore in 1989–90. Hon'ble Members are aware that the rate of interest on crop loans up to ₹ 15,000 was reduced last year and the reduction varied between 1 1/2 per cent and 2 1/2 per cent. With a view to extending the scope of relief, the Reserve Bank of India is today issuing instructions reducing the rate of interest charged on crop loans between ₹ 15,000 and ₹ 25,000 to 12 per cent from the existing maximum rate of 14 per cent.

The high incidence of overdues in the rural credit system, which continued to increase over the years, was a matter of serious concern as it tended to erode the financial soundness of the system. The Finance Minister in his budget speech of 1990–91 highlighted this:

> Over the years, poor farmers, artisans and weavers have accumulated debt which they are unable to repay. They have been caught up in a vicious circle of indebtedness and low incomes which keeps them in perennial poverty. In order to relieve our farmers from the burden of debt, an assurance was given in the National Front's manifesto that relief will be provided to farmers with loans up to ₹ 10,000 as on October 2, 1989. I am glad to inform the House that we are now ready with the scheme of implementation of debt relief

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13. Devaraja, T.S. (2011). *Rural Credit in India: An Overview of History and Perspectives.* Hassan: Department of Commerce, University of Mysore. May.

14. Shah, Mihir, Rangu Rao and P.S. Vijay Shankar (2007). "Rural Credit in 20th Century India: An Overview of History and Perspectives", *Economic and Political Weekly* 42(15). April 14–20.

> to fulfill the promise, and redeem the pledge given to the kisans and artisans. It is proposed to introduce a scheme for providing debt relief which will have the following features. The relief will be available to borrowers who have taken loans up to ₹ 10,000 from public sector banks and Regional Rural Banks. The relief will cover all overdues as on 2nd October 1989 including short-term as well as term loans. There will be no limit on the size of the borrower's land holdings. However, willful defaulters, who in the past did not repay loans despite their capacity to do so, will be excluded. The Central Government will compensate the public sector banks and Regional Rural Banks suitably for the debts which are thus written off. Many of those who filed insolvency petitions and had taken loans below ₹ 10,000 which were overdue as of 2nd October, 1989 will also be covered under the scheme. The State Governments may also wish to introduce a scheme on the same lines in respect of co-operative banks within their purview. Subject to the constraint of resources, the Central Government will consider suggestions for helping State Governments in implementing a debt relief scheme on the same pattern in respect of co-operative credit institutions under their control. I consider the debt relief measure as a positive step which will enable our farmers, artisans and weavers to increase their productivity. It is at the same time necessary to ensure that there is no erosion of the credibility of the banking system. Once the past over-dues are cleared, it is reasonable to expect that loans taken for current operations will be serviced promptly. The Scheme should contribute to better agricultural recoveries and better identification of willful defaulters, who do not deserve any sympathy. Banks are being asked to set up a system of maintaining a proper credit history of their borrowers covered under the Scheme. The Government would also like to make it clear that the Scheme will not be extended nor will it be repeated.

In terms of the Finance Minister's budget indications, the Reserve Bank finalised and communicated to banks guidelines for implementation of the debt relief scheme effective May 15, 1990. The Central Government made a provision of ₹ 1000 crore towards the debt relief scheme and committed to underwrite the entire burden of the relief provided by commercial banks and RRBs. In addition, the Central Government assured to provide 50.0 per cent assistance for the relief to be provided by the co-operative credit institutions. After the scheme was implemented, the major challenge for

the banking industry was to ensure that a multitude of fresh defaulters did not emerge again, choking the rural credit channels. It was essential that state governments effectively backed the efforts of commercial and co-operative banks in this regard. This was crucial in order to maintain the health of the rural credit system, so that it could continue to effectively support productive activity in the countryside.[15]

Under the scheme, debt relief of ₹ 10,000 was provided to eligible borrowers who fulfilled certain eligibility criteria. Accordingly, debt relief of ₹ 7,819 crore was provided under the scheme, of which public sector commercial banks provided ₹ 2,833 crore, the RRBs ₹ 793 crore and the co-operatives ₹ 4,193 crore. The Reserve Bank provided loans of ₹ 1,956 crore through NABARD to the state governments to meet their share of 50.0 per cent in the implementation of the scheme for the clients of co-operatives.

Banking in India had to operate under several constraints guided by socio-economic considerations that affected their profitability. These related primarily to rapid and vast expansion of banking facilities with associated costs, allocation of credit for priority needs and the element of cross-subsidisation to assist the preferred sectors. Banks were also subjected to a large pre-emption of funds by way of CRR and SLR, which also imposed constraints on their profitability. Several steps were taken to ease policy-related restrictions on profitability of banks. In the first phase, the measures aimed at directly improving profitability by increasing the administered rates, including an improvement in bond yields and interest on the eligible cash balances with the Reserve Bank. The second phase was marked by a move towards freeing the system, thus giving banks more discretion to set their rates competitively.

RATIONALISATION OF INTEREST RATES

On September 21, 1990, both the Department of Banking Operations and Development (DBOD) and the Rural Planning and Credit Department (RPCD) of the Reserve Bank issued a circular/directive at the instance of the Credit Planning Cell (CPC) on interest rates on advances to SCBs, including RRBs, and to the state co-operative banks/CCBs (Table 18.1). The notable feature of the new dispensation of lending rates announced was the linking of the interest rates to the size of the loan.

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15. Malhotra, R.N. (1990). *Rural Credit: Issues for 1990s.* Inaugural Address at the seminar organised by the Institute of Development Studies. Jaipur. August 27.

TABLE 18.1

Interest rate Structure on Advances

(Per cent)

Size of limit	*Rate of interest*
Up to ₹ 7,500	10.0
Over ₹ 7500 and up to ₹ 15,000	11.5
Over ₹ 15,000 and up to ₹ 25,000	12.5
Over ₹ 25,000 and up to ₹ 50,000	14.0
Over ₹ 50,000 and up to ₹ 2 lakh	15.0
Over ₹ 2 lakh	16.0 (minimum)

Source: Reserve Bank of India, circular dated September 21, 1990.

This rate structure was revised in April 1991 and then in July 1991, but only for the last category, *i.e.*, the interest rates for credit facilities over ₹ 2 lakh was revised to 17.0 per cent effective April 13, 1991 and then again to 18.5 per cent effective July 4, 1991). Despite these revisions, the principle of linking interest rates to the size of the limit remained unchanged, which created a furore among co-operative banks.

The Reserve Bank received representations/references from NABARD, various co-operative banks, the national federation of state co-operative banks and SCBs that were providing finance to PACS ceded to them. They represented that the new dispensation, which linked interest rates to the size of the limit, did not take into account the differential in lending rates, which was earlier maintained between the on-lending agencies both in the co-operative structure as well as in state co-operative banks lending to PACS. The matter was taken up with the CPC, which, after a detailed discussion with the top management, advised the RPCD as below and a rate structure finally emerged (Table 18.2):[16]

> To ensure uniformity of lending rates for ultimate borrowers, the SCBs would provide credit to the PACs at a rate 2.5 percentage points below the rate prescribed for direct lending by the SCBs for the relevant rate of advance by the PACs. In other words, if PACs lend for amounts up to Rs 7,500 per borrower at 10.0%, the PACs would be provided credit from the SCBs at 7.5%. The SCBs would be provided refinance from NABARD up to 60% of its lendings to PACs at the same rate at which the SCBs lend to PACs. The SCBs would limit their financing to only those PACs which are

16. SCBs in the quote refer to state co-operative banks and not scheduled commercial banks, as is the case in rest of the volume.

at present financed by them. The instructions to SCBs could be issued after DG (J) discusses this case with Chairman NABARD. The above discussions and the decisions were actually based on the writ petition filed by Andhra Pradesh High Court by Mulkanoor Co-operative Bank Ltd against State Bank of Hyderabad and the Reserve Bank challenging the application of interest rates revised with effect from 22nd September 1990. The issue was put up to the Governor and he gave his approval for revision. The interest rates had to be frequently revised and the objective was to reduce the interest rate gradually particularly in respect of loans beyond ₹ 2 lakh.

TABLE 18.2

Structure of Lending Rates

(Per cent per annum)

<table>
<tr><th rowspan="2">Category of Account</th><th colspan="3">Rate Effective</th></tr>
<tr><th>October 9, 1991</th><th>April 22, 1992</th><th>October 9, 1992</th></tr>
<tr><td>(1)</td><td>(2)</td><td>(3)</td><td>(4)</td></tr>
<tr><td>Size of Credit Limit:
Up to ₹ 7,500</td><td>11.5</td><td>11.5</td><td>11.5</td></tr>
<tr><td>Over ₹ 7,500 and up to ₹ 15,000</td><td>13.0</td><td rowspan="2">13.5</td><td rowspan="2">13.5</td></tr>
<tr><td>Over ₹ 15,000 and up to ₹ 25,000</td><td>13.5</td></tr>
<tr><td>Over ₹ 25,000 and up to ₹ 50,000</td><td>15.5</td><td rowspan="2">16.5</td><td rowspan="2">16.5</td></tr>
<tr><td>Over ₹ 50,000 and up to ₹ 2 lakh</td><td>16.5</td></tr>
<tr><td>Over ₹ 2 lakh</td><td>20.0*</td><td>19.0*</td><td>18.0*</td></tr>
</table>

Note: *: Minimum.

Source: Reserve Bank of India, internal documents.

PRODUCE (MARKETING) LOAN SCHEME

The scheme, initially introduced in 14 districts by the Government in December 1988 for loans not exceeding ₹ 10,000 to farmers by way of hypothecation of agriculture produce stored in a farmer's house or by pledge of the warehouse/rural godown[17] receipt, was kept in abeyance from

17. Godown is a storehouse in a village in which the farmer stores his produce.

April 1989 to March 1990. The scheme was, however, reintroduced for the 1990 *rabi* season and extended to eight additional districts in January 1991. By 1997, the scheme was in operation in 82 districts.

CASH CREDIT SYSTEM FOR AGRICULTURAL ADVANCES

Only a few banks provided cash credit facilities to a limited number of farmers subject to certain conditions. To ensure adequate and timely flow of rural credit as also to meet the composite needs of farmers, the Reserve Bank advised the banks in October 1994 to extend cash credit facilities to farmers for irrigation facilities and also for non-farm/allied activities.

Commercial banks were advised to set up at least one specialised agricultural finance branch (SAFB) in each state by the convenors of the respective SLBC to deal with high-tech agricultural loans. At end-June 1995, there were 735 specialised branches, of which 70 were SAFBs (Table 18.3).

TABLE 18.3

Number of Specialised Branches

(As on June 30, 1995)

Specialisation Category	*Public Sector Banks*	*Private Sector Banks*	*Total*
(1)	*(2)*	*(3)*	*(4)*
Industrial Finance Branch	85	10	95
Agricultural Finance Branch	69	1	70
SSI Branch	164	17	181
Capital Market			
Service Branch	15	–	15
Corporate Finance Branch	5	–	5
Overseas Branch	87	7	94
NRI Branch	49	15	64
Housing Finance Branch	2	–	2
Leasing Finance Branch	1	–	1
Others	204	4	208
Total	681	54	735

Note: – : Not available/nil.

Source: Reserve Bank of India, *Report on Trend and Progress of Banking, 1994–95.*

To promote investment in commercial or high technology agriculture and allied activities, state-level agricultural development financial institutions were proposed to be set up, with NABARD as the chief

promoter. The Reserve Bank advised PSBs to prepare special agricultural credit plans. For the financial year 1995–96, disbursements under the plan were ₹ 10,173 crore as against the projection of ₹ 12,121 crore.

LOCAL AREA BANKS

In order to promote mobilisation and deployment of rural savings by local institutions, the concept of local area banks (LABs) with jurisdiction over two to three districts was evolved to cater to the credit needs of the local people and to provide efficient and competitive financial intermediation services in their areas of operation. This was expected to provide the much-needed competition to the existing financial institutions in those areas. As proposed in the Union Budget for 1996–97, guidelines were issued in August 1996 for setting-up new private LABs with jurisdiction over two or three contiguous districts in order to promote rural saving, bridge the gaps in credit availability and enhance the institutional credit framework in rural and semi-urban areas. A minimum paid-up capital of ₹ 5 crore was stipulated for such banks. The Reserve Bank granted in principle approval for the establishment of three LABs. These banks would be promoted by individuals, corporate entities, trusts and societies and should have a minimum paid-up capital of ₹ 5 crore, of which the promoters' contribution should be at least ₹ 2 crore. They would have to observe the priority sector lending target of 40.0 per cent of net bank credit and a sub-target of 10.0 per cent of net bank credit for lending to weaker sections as applicable to other domestic banks. They would also adhere to the prudential norms, accounting policies and other policies as laid down by the Reserve Bank. These banks would have to achieve capital adequacy of 8.0 per cent of the risk-weighted assets and norms for income recognition, asset classification and provisioning from their inception. The interest rates on advances in their case would be deregulated. LABs would be registered as public limited companies under the Companies Act, 1956. They would be licensed under the BR Act, 1949 and would be eligible for inclusion in the second schedule to the RBI Act, 1934.

CONCLUDING OBSERVATIONS

Although agriculture was recognised to be the backbone of the economy, the fact remained that over a period it lost its importance in terms of access to financial support. The regulatory and social compulsions with which banks had been providing assistance for agriculture and rural

development were gradually disappearing. Although agricultural credit by various agencies rose from ₹ 15,169 crore in 1992–93 to ₹ 28,653 crore in 1996–97, the share of agricultural credit in the total was on the decline. Even after a significant increase in overall agriculture credit, there was a serious problem of overdues that dampened the flow of credit, besides adversely affecting the economic viability of lending institutions, especially the co-operatives and the RRBs. The recovery of agricultural advances by commercial banks, however, improved from 54.2 per cent in 1992 to 61.9 per cent in 1996.

Gross capital formation in agriculture increased from ₹ 4,729 crore (₹ 1,002 crore public share and ₹ 3,727 private share) in 1992 to ₹ 6,999 (₹ 1,132 public share and ₹ 5,867 private share) in 1997. The decline in share of public investment was attributed to the diversion of resources from investment to current expenditure. A large portion of public expenditure on agriculture in the early 1990s went into current expenditure in the form of increased output and input subsidies.

The Eighth Plan stipulated that the level of investment in agriculture should be raised to at least 18.7 per cent of the total investment. However, it could at best reach 11.0 per cent of the total investment. During the Eighth Plan, investments in the agricultural sector, particularly for the creation of irrigation potential, fell short of the target despite the efforts made to reverse the trend by introducing the accelerated irrigation benefit programme. As at end-March 1997, PSBs had exceeded their priority sector credit target with a total lending of ₹ 79,131 crore, which constituted 41.7 per cent of the net bank credit. As at end-March 1997, 353 specialised SSI bank branches were operationalised.

Disbursement to agriculture under the special agricultural credit plans, prepared on the advice of the Reserve Bank was ₹ 12, 716 crore during 1996–97. The policy to channelise the shortfall in priority sector lending by banks into rural infrastructure investment continued during 1997–98. Apart from the RIDF-III corpus of ₹ 2,500 crore, the Union Budget for 1998–99 announced the establishment of RIDF-IV with a corpus of ₹ 3,000 crore.

The commercial banks were allowed to consider merit proposals for term finance/loans in the form of lines of credit to SIDCs and SFCs. The extent of such loans to SSIs was treated as a part of priority sector lending. The priority sector target was set at 40.0 per cent even for new private sector banks The Union Budget for 1995–96 took further initiatives to improve the credit flow to the rural sector and SSIs and announced several

schemes, *viz.*, RIDF with a corpus of ₹ 2,000 crore, the scheme of loans to STs, a seven-point action plan for improving the flow of credit to the SSIs, ensuring availability of bank finance for PWCS and weavers in the handloom sector, instituting technology development and modernisation fund and extending bank credit to the KVIBs.

In order to align the priority sector lending of foreign banks operating in India with that of Indian banks, the target of priority sector lending by foreign banks was raised in October 1993 from 15.0 per cent to 32.0 per cent of their net bank credit, inclusive of two separate sub-targets of at least 10.0 per cent each in respect of advances to SSIs and exports to be achieved by the end of March 1994. Taking into account their difficulties in extending credit to the agricultural sector due to the lack of rural branch network, the composition of priority sector advances for foreign banks was enlarged to include export credit extended by them with effect from July 1, 1993. It was stipulated that in the event of any shortfall in the target at end-March 1994, the foreign banks would have to make good by placing a deposit with the SIDBI. Accordingly, nine foreign banks that could not meet the target deposited ₹ 310 crore with the SIDBI. As at end-March 1994, the advances to the priority sector by foreign banks stood at ₹ 3,177 crore, accounting for 32.0 per cent of their net bank credit. The overall target of priority sector lending in respect of foreign banks remained unchanged at 32.0 per cent of net bank credit, with a sub-target of 10.0 per cent in respect of advances to SSIs. The sub-target for export credit was, however, raised from 10.0 per cent to 12.0 per cent of net bank credit for the year ending March 1997. In case of any shortfall in priority sector lending from the targets and sub-targets, the policy prescription of placing deposits equivalent to the shortfall with the SIDBI (at an interest rate of 8.0 per cent per annum) was maintained.

Although the need to augment growth of agriculture and rural employment found expression in the policies of the Government, the economic reforms were largely confined to industry, trade and commerce. The balance of payments (BoP) crisis of 1991 induced economic reforms that, in a way, sidelined agriculture. The financial sector reforms placed emphasis on productivity, efficiency and profitability of banking, which compelled the banking system to focus on viability-based expansion of business and, at the same time, extend finance for agricultural and rural sector development as a fait accompli under policy compulsions of relaxed terms and conditions with reference to interest rates and other regulatory requirements. Several employment-linked programmes with subsidies,

particularly to uplift weaker sections and micro-credit system of extending finance were attempted on an experimental basis, but the fact remained that agriculture and rural sector did not take-off as envisaged to support the growth process.

The Reserve Bank continued to play a key role in developing this sector by providing refinance and giving policy as well as regulatory support and guidance to NABARD, scheduled banks, including RRBs, and the co-operative sector. NABARD, established in 1982 as an apex national bank to exclusively cater to agriculture and rural development, continued to depend on the Government and the Reserve Bank for its resources and operations. It emerged as a refinancing body rather than a development agency. Despite being the backbone of the economy, agriculture and rural segment lagged behind other sectors in getting the focused attention. The reforms initiatives proposed in the report of the Narasimham Committee were centred at ensuring viability of banking and making it competitive and efficient.

The SAA focused attention on decentralised and micro-credit planning by rural and semi-urban branches of commercial banks and RRBs, with the support of NABARD. A small farmers' agri-business consortium was formed to provide better employment opportunities to farmers by way of diversified agricultural activities and improvement in efficiency of production through technological upgrading. A sharper thrust on improving agricultural production, which was sought to be achieved by various policy measures and institutional changes, concomitantly necessitated expanding and diversifying the operations of rural/agricultural credit delivery agencies, with the ultimate objective of enhancing the quality of rural lending.

Apart from strengthening commercial banks and RRBs, several measures were initiated to ameliorate problems in the flow of agricultural credit. First, the coverage of rural credit was extended to include facilities such as storage as well as credit through NBFCs. Second, procedural and transactional bottlenecks were sought to be removed by reducing margins, redefining overdues to coincide with crop-cycles, introducing new debt-restructuring policies and one-time settlement and relief measures for farmers indebted to non-institutional lenders. Third, the KCC scheme was improvised and its coverage widened, while some banks popularised general credit cards (GCCs), which was in the nature of a clean overdraft for multipurpose use, including consumption. Fourth, public and private sector banks were encouraged to enhance credit delivery while

strengthening disincentives for shortfall in priority sector lending. Fifth, banks were urged to price the credit to farmers based on actual assessment of individual risk rather than on a flat rate, depending on the category of borrower or end-use, while ensuring that the interest rates charged were justifiable as well as reasonable. Other measures were also initiated that covered delegation of more powers to branch managers, simplification of applications, opening of more SSI specialised branches, an enhancement in the limit for composite loans and strengthening of the recovery mechanism. In a nutshell, the thrust was on improving credit delivery in a regime of reasonable costs within the existing legal and institutional constraints.