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Rural Credit Policy

INTRODUCTION

Recognising the importance of the rural and, in particular, agricultural sector in India's development, the Government and the Reserve Bank emphasised a broad-based institutional framework for catering to the increasing credit requirements of the sector. While the overall objective of rural credit delivery was guided by the considerations of ensuring adequate and timely availability of credit at reasonable rates of interest through the expansion of institutional framework, the relevant approach and policies including the credit delivery mechanism were periodically reviewed to attune to the changing requirements of the rural sector. The rural credit system in the country thus witnessed significant changes over time in terms of focus, structure and approach.

The institutional arrangement for purveying rural credit consisted of a three-tier co-operative structure till 1969, with the Reserve Bank playing a promotional and developmental role since its inception in 1935. The all-India rural credit review committee[1] expressed that co-operatives did not measure up to expectations in mobilising deposits and disbursing credit. The committee, therefore, felt that efforts of the co-operatives had to be supplemented and it recommended adoption of a multi-agency approach to cater to credit needs of rural areas with a much larger role for commercial banks. Thus, after nationalisation of 14 major commercial banks in 1969, followed by another 6 banks in 1980, commercial banks assumed a relatively dominant role in purveying rural credit during the decades of the 1970s and the 1980s. Since institutional credit was perceived

1. Reserve Bank of India, 1969.

to be inadequate in meeting the requirements of weaker sections of the rural community, regional rural banks (RRBs) were established in 1975 as an institutional innovation combining both commercial and co-operative principles to especially meet the credit needs of weaker sections of society. This multi-agency system for purveying rural credit came to be accepted as a viable and appropriate mechanism for rural development during the Sixth and Seventh Five Year Plan periods.

The policies towards rural credit during the 1980s were influenced by the thinking that in developmental planning, the trickle-down theory did not work and provision of credit and employment to vulnerable sections needed to be targeted and prioritised for better distribution of benefits accruing from economic growth. Thus, priority sector lending — directing institutional credit flow through regulatory guidelines and directives — characterised the approach to rural credit. This policy, which had strong political backing, was at times taken to the extreme of overriding the regulatory and prudential banking operations. The controversial loan *melas* were thus organised during this period.

The targeted lending was complemented by evolution of an integrated and area-based approach at different levels, *viz.,* the village, the block, the district and the state, with supporting institutional arrangements, such as, district and state-level committees aided by regulatory participation, aimed at planning and monitoring the flow of credit to the desired groups, activities and sectors.

In this milieu, the Reserve Bank continued to play a promotional role, though its efforts were dispersed and were somewhat diluted after the creation of the apex institution, the National Bank for Agriculture and Rural Development (NABARD) in July 1982. Most of the supervisory functions in the context of rural credit were transferred to the new institution.

The Governor, Dr Manmohan Singh,[2] commenting on the changed role of the Reserve Bank, said:

> …the establishment of NABARD, in a sense, marks the end of an era of the Reserve Bank's direct involvement in rural credit and the Reserve Bank's legacy becomes the heritage of NABARD. Of course, this change will in no way affect the Reserve Bank's deep and abiding interest in the orderly growth of the rural credit system, in line with the broad national objectives and priorities of development.

2. Reserve Bank of India (1985). "Foreword", in *The Reserve Bank and Rural Credit.*

Though NABARD was set up as the apex development finance institution (DFI) to regulate rural credit and promote integrated rural development in the country, the Reserve Bank did not delegate all its powers to NABARD. The Agricultural Credit Department (ACD) monitoring the short-term credit structure ceased to exist, and the functions of the erstwhile Agricultural Refinance and Development Corporation (ARDC), a Reserve Bank subsidiary, were subsumed in the new institution. The Rural Planning and Credit Department (RPCD) was at the same time set up in the Bank, which assumed the overall regulatory role for rural credit.[3] The obligations cast upon the Reserve Bank under section 54 of the Reserve Bank of India (RBI) Act were amended envisaging that the Bank maintained expert staff to study various aspects of rural credit and development, tendered expert guidance and assistance to NABARD, and conducted special studies in rural areas, which it considered necessary for promoting integrated rural development.

BANKING POLICY AND RURAL CREDIT: REACHING OUT TO MASSES

The government policy towards rural credit in the 1980s maintained a thrust on eradicating poverty and reducing inequality of income. This was achieved by developing agriculture, providing employment opportunities and uplifting the weaker strata of the society. The policy found expression in various budget speeches of the period 1982–83 to 1988–89. In the 1982–83 budget speech, the Finance Minister, Shri V.P. Singh observed that the operations of public sector banks (PSBs) had been further oriented towards extending banking facilities to under-banked rural and semi-urban areas, and enlarging the flow of credit to priority sector, particularly the weaker sections. He categorically stated that the objective of the policy in 1982–83 was to maintain the momentum of growth and make efforts to achieve the socioeconomic objectives of the Sixth Plan. This called for increasing investments, achieving higher productivity levels, enhancing efficiency and reducing disparities. The approach continued in 1983–84 with an increased outlay under various government-sponsored schemes, such as the twenty-point programme and the integrated rural development programme (IRDP).

The budget speech of 1985–86 quoted former Prime Minister, Smt Indira Gandhi, who emphasised, "No section of our vast and diverse

3. RRBs were regulated by the Reserve Bank of India and not by NABARD.

population should feel forgotten. Their neglect is our collective loss." The Finance Minister added, "Agriculture and rural development is at the centre of our planning. Control of inflation, reduction in poverty levels, promotion of employment and improvement in our balance of payments are goals which are linked with our success in agriculture." The subsequent budgets endorsed the earlier policies and gave an impetus to rural development through necessary budgetary provisions and improved institutional spread.

The argument that rural presence energised rural credit was the guiding philosophy of the Government and the Reserve Bank after some of the major commercial banks were nationalised in 1969. This led to large-scale branch expansion by the nationalised banks in rural areas. It also cast the Reserve Bank in a unique role of harmonising the principles and discipline of commercial and social banking. In line with its developmental role, the Reserve Bank began to work in partnership with the Government in guiding and directing the banking system to cater to the social and economic needs of the people. Development of FIs, institutionalisation of savings, meeting the credit requirements of major and critical segments of the economy, particularly the weaker sections of society, and channelling the resources according to Plan priorities were some of the challenges that the Reserve Bank tried to address during this period.

The spirit, with which the Reserve Bank associated with the Government in nurturing social banking in the 1980s, while at the same time maintaining that banking indeed was a commercial proposition, was unique for any central bank. The approach to branch licensing policy, savings mobilisation and use of the instruments of credit as part of the policy in the 1980s were the building blocks of social banking: they fostered banking habits among masses, without seriously jeopardising the commercial character of the banking business. As a result, the institutional structure for rural finance received an unprecedented stimulus and social banking came to be recognised as an inevitable proposition for all institutions associated with rural credit in general, and agricultural credit in particular. The Reserve Bank, thus, played a pioneering role in developing such a framework for the short, medium and long-term financing of agriculture.

The Reserve Bank on its own or in co-ordination with the Government introduced several schemes at concessional rates of interest, with favourable treatment in credit appraisal in order to facilitate credit access to the priority sector; in particular, agriculture, the weaker sections and scheduled castes and scheduled tribes (SCs/STs). It continually monitored and reviewed the progress of these schemes so as to introduce the required corrective steps, as and when necessary.

The justification for offering credit at concessional rates to certain categories of borrowers was based on the premise that farm-based investment activities, in the short run, did not always yield returns to enable regular servicing of loans, while at the same time meeting the minimum consumption requirements. Since concessional lending impacted the profitability of rural financial institutions, a policy of cross-subsidisation and refinance from the Reserve Bank and later NABARD was put in place simultaneously. This was broadly the policy framework, which prevailed for over two decades.[4]

These strategies, however, brought with them some negatives. Extending banking to rural areas was not an easy task. Governor Malhotra[5] observed in this context:

> Inadequate development of infrastructure has been a serious constraint. Recruitment, training, reorientation and placement of banks' staff, mostly with urban backgrounds have posed difficult problems. Chains of command within banks have stretched, making supervision and control less effective. Add to this the hazards of rural lending, social pressures, the multiplicity of purposes for which credit is needed and the relative inexperience of young bank managers and you get an idea of the stupendous effort that banks have made in establishing a strong presence in and increasing manifold the flow of lending to rural areas.

Social banking and mass banking received significant target orientation in the late 1980s without adequate emphasis on their implications for the viability of such activities. While cross-subsidisation was accepted as a conscious policy to support rural and other priority sector bank lending, poor recoveries and increase in non-performing loans (NPLs) became serious issues. The Narasimham Committee report[6] in this context noted:

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4. Thorat, Y.S.P. (2005). *Rural Credit in India and Concerns*. Presidential Address at the Society of Agricultural Economics. November 24.
5. Malhotra, R.N. (1986). *Role of Banking in Rural Development*. Speech delivered at the Fifth Anniversary Lecture. Colombo: Rural Banking and Staff Training College, Central Bank of Sri Lanka. September 19.
6. The committee on the financial system (Chairman: M. Narasimham), 1991.

> Priority sector lending was supposed to be a means to the broader end of improving the economic condition of 'the neglected sectors of the economy'. However, the way the policy was interpreted and pursued, the means became the ends in lending. Banks were pulled up for not meeting their credit target; and what happened in banks down the line was that bank managers were interested in ensuring that they lent more money to these sectors…the emphasis was on providing the credit and there was no equal emphasis on recovery of credit…loan melas which showed an official blessing for the abandonment of the principle of credit appraisal…the credit appraisal took a backseat…loan waivers can be regarded as the prodigy of those melas.

A number of scholarly studies outside the Reserve Bank pointed to the impact of rural credit since the beginning of the 1970s. These helped to understand the challenges faced by the Reserve Bank and the Government in working out necessary programmes for rural and agricultural development. Burgess and Pande (2003, 2005)[7] in their study on the economic impact of the explosive growth in rural banking during the period 1970–1992 found that branch expansion in the banked and unbanked areas had a significant positive impact on the growth of non-agricultural output, contributed to the growth of small businesses and led to an increase in the share of non-agricultural labour in the total workforce as also to rise in the real wages of agricultural labour. The study also found that the penetration of banks into unbanked areas reduced aggregate poverty and the rural-urban poverty differences besides facilitating a reduction in aggregate inequality in the economy. The study concluded that the favourable results were precisely due to the social elements of India's banking experiment, *viz.*, expansion into unbanked locations and priority sector lending.

Another study by Cole (2008)[8] encapsulated the performance of government-owned banks in the rural credit area: the growth rate of agricultural credit lent by public banks was 5.0–10.0 percentage points higher in the election years than in the years after an election, and in election years more loans were made to the districts in which the ruling

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7. Burgess, R. and R. Pande (2003, 2005). "Do Rural Banks Matter? Evidence from the Indian Social Banking Experiment", *BREAD Working Paper* No. 037/2003 and *American Economic Review* 95(3): 780-95. June 2005.

8. Cole, Shawn A. (2008). "Fixing Market Failures or Fixing Elections? Agricultural Credit in India", *Harvard Business School Working Paper* No. 09-001. July.

state party had faced a narrow margin of victory (or a narrow loss) in the previous election. This targeting did not occur in the non-election years. The paper showed that politically motivated loans were economically costly. They were less likely to be repaid. Nor were they put to good use; election year credit booms did not measurably affect agricultural output. Finally, the measure of whether the average agricultural loan was beneficial, using variation induced by bank nationalisation of the 1980 showed that agricultural credit in villages with nationalised bank branches grew more than twice as quickly than in the villages with private branches over the 1980s. However, this additional credit had no effect on measured agricultural outcomes.

To quote Dr C.H. Hanumantha Rao, "In our planning, we wanted to bring land development and eradicate poverty in 2–3 Plans, but this never happened. Instead of planning influencing our social structure, our social structure began influencing planning. By and large, in the late 1980s, the rural credit situation became very discouraging because of loan write-offs, waivers and all kinds of things; that was a very bad period for rural credit system when political interference was at its highest. Some of the things are consequences, but not because of the nationalisation *per se* but because of political interference which was perhaps made easier because of nationalisation of banks."[9]

Contributing to the public debate on Indian banking system, an eminent economist[10] observed:

> The nationalised sector of the banking system is subject to other forms of intervention, all designed to serve one or another public policy and almost all, without exception, making a severe dent in the viability of the system. Targets of rural branch expansion, priority sector lending, repressive interest rate policies have all been responsible for the deterioration in the quality of performance, even as quantitative growth has been spectacular. Perfectly legitimate public policy objectives have been sought to be pursued by sub-optimal instruments, which have caused many distortions in the allocation of resources. As if this were not enough, the personalised style of interventions, and political gimmicks such

9. Transcript of the interview with Dr C.H. Hanumantha Rao, former Member, Planning Commission, Government of India, November 16, 2006.

10. Shroff, Manu (2009). "Reform in Indian Banking: Agenda for Action", in *Indian Economy: A Retrospective View*. Edited by Deena Khatkhate. p.168: para 2.

> as loan melas and loan waivers, have brought the legitimate social objectives into disrepute. Successive Governments have thought of bank deposits as public resources to be deployed at will by the elected representatives of the people, totally confusing the term public in its two senses. Such perverse perceptions of the accountability of the banking system are at the root cause of the problem faced by the system.
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> Politicians have to be made to recognise that banks are primarily accountable to the depositors, just as the insurance companies are to policyholders and mutual funds to their investors. Ownership means little or should mean little in such financial organisations.

Adding to the debate, another view expressed in this context was that the significant increase in credit flow from institutional sources brought forth a strong sense of expectation from PSBs. This expectation, however, could not be sustained as the emphasis throughout was on achieving certain quantitative targets. As a consequence, inadequate attention was paid to the qualitative aspects of lending, resulting in loan defaults and erosion of repayment ethics for all categories of borrowers. The end result was a disturbing growth in overdues, which not only hampered recycling of scarce resources of banks but also affected profitability and viability of FIs. Ultimately, financial deepening occurred but the development impact of rural finance was blunted. Resultantly, in 1991, on the eve of reforms, the rural credit delivery system was in a poor shape.

Notwithstanding such pressures and hurdles, the overall achievement in spreading banking to rural areas was commendable. This, combined with aggressive strategies for expanding rural credit, exerted a positive influence on agricultural production. The number of rural branches increased sharply from 1,833 in June 1969 to 17,656 in March 1981 and further to 35,206 in March 1991. The proportion of rural branches to total branches increased from 22.0 per cent in June 1969 to 49.4 per cent in March 1981 and further to 58.5 per cent in March 1991.

According to the All-India Rural Debt and Investment Survey (AIRDIS), the relative share of borrowing of cultivator households from commercial banks improved significantly during the 1980s from 28.8 per cent in 1981 to 35.2 per cent in 1991, whereas that of co-operatives declined from 29.8 per cent to 23.6 per cent during the same period. The proportion of credit availed from the non-institutional sources declined from 36.8 per cent to 30.6 per cent during the review period.

The share of institutional flow of short-term credit through commercial banks improved significantly. In terms of disbursements, while scheduled commercial banks (SCBs) improved their share from 27.2 per cent to 36.4 per cent, the co-operatives saw their shares declining from 72.8 per cent to 61.3 per cent. The share of RRBs, after improving from 3.8 per cent in 1982–83 to 5.4 per cent in 1989–90, declined to 2.2 per cent in 1990–91. Similar trends were seen in the case of outstanding short-term credit from these sources (Table 8.1). The share of respective institutions with regard to term credit flow also followed a similar pattern (Table 8.2).

The share of term credit in gross capital formation in agriculture and allied activities also improved from 28.4 per cent in 1980–81 to 35.1 per cent in 1990–91 (Table 8.3).

TABLE 8.1

Shares of Institutional Sources in Short-term Credit to Agriculture 1980–1991

(Per cent)

Year	*Disbursements*			*Outstanding*		
	SCBs	*Co-ops.*	*RRBs*	*SCBs*	*Co-ops.*	*RRBs*
1980–81	27.2	72.8	–	34.5	65.5	–
1981–82	29.0	71.0	–	32.3	67.7	–
1982–83	22.0	74.2	3.8	36.7	60.4	2.9
1983–84	27.7	68.5	3.8	37.7	58.9	3.4
1984–85	29.6	66.6	3.8	39.2	56.6	4.1
1985–86	30.0	65.8	4.2	40.2	55.3	4.5
1986–87	34.4	60.9	4.7	42.0	52.8	5.2
1987–88	33.2	61.9	4.9	41.8	52.7	5.4
1988–89	31.5	64.1	4.5	39.9	54.5	5.6
1989–90	30.6	64.0	5.4	42.0	51.9	6.0
1990–91	36.4	61.3	2.2	42.3	51.8	5.9

Note: '–': not available.

Source: Aggarwal, K.P., V. Pugazhendhi and K.J.S. Satsai (1997). "Gearing Rural Credit for Twenty First Century", *Economic and Political Weekly*, October 18–24.

TABLE 8.2

Shares of Institutional Sources in Term Credit to Agriculture 1980–1991

(Per cent)

Year	*Disbursements*			*Outstanding*		
	SCBs	*Co-ops.*	*RRBs*	*SCBs*	*Co-ops.*	*RRBs*
1980–81	53.7	46.3	–	43.9	56.1	–
1981–82	54.5	45.5	–	44.6	55.3	–
1982–83	41.4	50.8	7.8	46.6	48.9	4.6
1983–84	51.6	40.9	7.5	50.7	44.3	4.6
1984–85	58.5	34.1	7.3	53.6	40.7	5.7
1985–86	56.1	35.3	8.6	58.4	35.7	5.8
1986–87	57.7	33.7	8.6	57.8	35.8	6.3
1987–88	50.4	43.2	6.4	60.8	32.6	6.6
1988–89	58.6	36.6	4.9	61.9	31.1	7.0
1989–90	57.7	34.7	7.5	62.1	30.9	7.0
1990–91	62.4	32.6	5.0	66.3	27.7	6.0

Note: '–': not available.

Source: Same as in Table 8.1.

TABLE 8.3

Real Private Capital Formation in Agriculture vis-à-vis Institutional Credit

(₹ crore)

Year	*Public Sector*		*Private Sector*		*Total*		*Flow of Term Credit*	*Credit as Per cent to Capital Formation in Agri+ Allied Sectors*
	Agriculture	*Agri+ Allied Sectors*	*Agriculture*	*Agri+ Allied Sectors*	*Agriculture*	*Agri+ Allied Sectors*		
1980–81	1,796	1,892	2,840	2,972	4,636	4,864	1,382	28.4
1981–82	1,779	1,878	2,720	2,863	4,499	4,741	1,337	28.2
1982–83	1,725	1,857	2,850	3,008	4,575	4,865	2,063	42.4
1983–84	1,707	1,843	2,390	2,563	4,097	4,406	1,405	31.9
1984–85	1,673	1,822	2,878	3,066	4,551	4,888	1,511	30.9
1985–86	1,516	1,631	2,806	3,010	4,322	4,641	1,931	41.6
1986–87	1,428	1,550	2,587	2,810	4,015	4,360	1,916	43.9
1987–88	1,450	1,576	2,964	3,202	4,414	4,778	1,952	40.9
1988–89	1,362	1,482	2,985	3,252	4,347	4,734	2,029	42.9
1989–90	1,156	1,301	3,197	3,490	4,353	4,791	1,969	41.1
1990–91	1,154	1,313	3,439	3,761	4,593	5,074	1,782	35.1

Source: Same as in Table 8.1.

AGRICULTURAL REFINANCE AND DEVELOPMENT CORPORATION

The emphasis on flow of credit to agriculture in the framework of a multi-agency approach raised certain issues such as, multiple regulators and lack of co-ordination in credit delivery.

The ARDC continued to play an active role in providing refinance for viable investments in agriculture and allied activities, and in promoting development and technical assistance in these areas of economic activity during the year 1981–82. The participatory role of the ARDC increased in line with the emphasis on the IRDP and rural credit expansion in the Sixth Five Year Plan. The cumulative number of schemes sanctioned up to end-June 1982 by the ARDC since its inception was 19,611, involving ₹ 4,650 crore of commitment and ₹ 2,808 crore of disbursements. The purposes covered under ARDC assistance were minor irrigation, land development/command area development, farm mechanisation, plantation/horticulture, poultry/sheep breeding/piggery, fisheries, dairy development, storage/market yards and others. The agencies assisted by the ARDC were state land development banks (SLDBs), SCBs and state co-operative banks. The corporation concentrated on developing and promoting agricultural investments in less developed and/or under-banked states.

The corporation sought to cover more and more small farmers in line with the national objective of assisting small farmers in an attempt to improve their economic lot. As at end-June 1982, it provided assistance to 918 schemes for an amount of ₹ 137 crore. It offered small farmers a concessional rate of interest of 10.25 per cent as against 12.5 per cent generally payable by the farmers.

During 1981–82, the corporation took some major decisions, which, *inter alia,* included enhancing the rate of its contribution to special debentures floated by the SLDBs between September 1981 and March 1985 on a request by the Central Government; providing interim finance to banks in consultation with the Reserve Bank with a view to helping farmers purchase tractors during the 1981–82 *kharif* season; and liberalising its refinance scheme to enable the state electricity boards (SEBs) to obtain enhanced financial assistance from banks.

During 1981–82, the corporation successfully completed credit projects, such as the International Development Association (IDA)/International Bank for Reconstruction and Development (IBRD) projects involving an amount of US$ 350.0 million. These included the Himachal

Pradesh Apple Processing and Marketing Project and the Chambal Command Area Project. As at end-June 1982, 41 projects were sanctioned assistance by the World Bank Group, involving a sum of US$ 1,550.0 million to be routed through the corporation.

FORMATION OF NABARD

In 1979, the Reserve Bank set up a committee to review arrangements for institutional credit for agriculture and rural development (CRAFICARD). The major outcome of the committee's recommendations, submitted to the Reserve Bank in 1981, was the establishment of NABARD. The institutional credit structure for agricultural and rural development got a fillip with the creation of NABARD.[11] The necessary legislation was enacted in 1981–82 and NABARD commenced operations on July 12, 1982.

The statute, under which NABARD was formed provided for an organic link between NABARD and the Reserve Bank. NABARD worked under the general guidance of the Reserve Bank during its formative years. As Governor Manmohan Singh[12] observed:

> NABARD has inherited the tradition from RBI which had rendered 50 years of great service in the area of agricultural credit, institution building, rural development which is a glorious chapter in the RBI history. Continuing, NABARD has to proceed ahead with this rich heritage and on it rests a great deal, for bringing about a satisfactory rural delivery edifice. RBI, however, as the Central Bank of the country which derives more than 40 per cent of GDP coming from agriculture and 70 per cent of population deriving their income from agriculture as vocation, would continue to take interest in rural development — in fact, no central bank of the country can afford to be a passive body in ensuring for it the needed health in the vital sector of the economy. RBI cannot get away from the task of alleviating the poverty in the country and NABARD is the arm through which RBI is going to implement this.

11. The third volume of the history of the Reserve Bank of India (1969–1981) extensively covers the setting-up of NABARD.
12. Address at the first conference of officers-in-charge of regional offices of NABARD held in April 1983. Also recorded as Foreword by Dr Manmohan Singh to "The Reserve Bank and Rural Credit", Reserve Bank of India, 1985.

RURAL PLANNING AND CREDIT DEPARTMENT

The core activities of the RPCD included formulating policies relating to priority sector advances, assessing the quantitative and qualitative performance of commercial banks in lending to the priority sector, weaker sections and under special poverty alleviation programmes; monitoring the implementation of the lead bank scheme (LBS) and service area approach (SAA); providing financial support to NABARD, guiding and advising it on matters of rural credit; and ensuring that the state and central co-operative banks as well as RRBs complied with the provisions of the RBI Act, 1934, the Banking Regulation (BR) Act, 1949, and the rules framed under these Acts.

The policies governing commercial banks' lending to priority sector of the economy and the definitions of priority sector were laid down by the department in co-ordination with the Government as also in consonance with the general credit policy pronouncements made by the Reserve Bank. The department was required to closely monitor the banks' performance, sector-wise, to ensure that they met the targets fixed by the Reserve Bank. The RPCD had 16 regional offices and a cell at Nagpur that worked under the Bombay Regional Office.

Conceived as an exercise in decentralisation of the Reserve Bank's functions in the sphere of rural credit, NABARD took over the entire functioning of the ARDC. Also, the refinancing functions in relation to state co-operative banks and RRBs were separated from the Reserve Bank and entrusted to NABARD. With a view to promoting integrated rural development and securing rural prosperity, NABARD provided refinance to promote agriculture, small scale industries (SSIs), cottage and village industries, handicrafts, other rural crafts and allied economic activities in rural areas.

NABARD was made into a statutory body under an Act of Parliament, and financing of non-farming activities were included as part of the activities of the institution. The Deputy Governor, Shri M. Ramakrishnayya carried out the functions of the Board in the early period till a formal board was constituted. Efforts were made to persuade the Reserve Bank staff to continue in NABARD in an attempt to retain the experienced manpower, though these attempts did not meet with much success. Endeavours were also made to get a short-term line of credit from the Reserve Bank to sustain the viability of co-operative institutions in rural lending, despite some reservations on the part of the Reserve Bank.

The authorised share capital of NABARD was ₹ 500 crore and the paid-up capital was ₹ 100 crore, contributed equally by the Reserve Bank and the Government. The national agricultural credit (long-term operations) [NAC (LTO)] fund with the Bank was transferred to NABARD to form part of its national rural credit (long-term operations) [NRC (LTO)] fund, which could be used to provide term loans. NABARD was permitted to raise resources from the Government and the market. It could also draw on assistance from the Reserve Bank for short-term credit and working capital loans.

The role and activities envisaged for NABARD encompassed:

(i) Provision of refinance for all categories of production and investment credit to agriculture, SSIs, artisans, cottage and village industries, handicrafts and other allied economic activities.

(ii) Funds for its loan operations to be drawn from the Central Government, the World Bank and other multilateral and bilateral agencies, by borrowing from the market and the NRC (LTO& stabilisation[S]) funds. The resources of the NAC (LTO) fund and the NAC(S) fund stood transferred to the above–mentioned funds of NABARD. The Reserve Bank also committed to provide a line of credit for NABARD's short-term operations.

(iii) Besides providing short-term, medium-term and long-term credits to SCBs, RRBs, LDBs and other FIs approved by the Reserve Bank, NABARD extended loans to state governments for periods not exceeding 20 years to enable them to subscribe directly or indirectly to the share capital of co-operative credit societies. It also provided long-term loans directly to any institution approved by the Central Government and contributed to the share capital or invested in the securities of any institution concerned with agriculture and rural development.

(iv) NABARD took over the responsibility of co-ordinating the activities of the Government of India (GoI), the Planning Commission, the state governments and other all-India and state-level institutions entrusted with the development of SSIs, industries in the tiny sectors, village and cottage industries, and rural crafts.

(v) It was entrusted to maintain a research and development fund to promote research in agriculture and rural development, supported by a database to be created for the purpose. This fund was envisaged to help in formulating and designing projects/

programmes to suit the requirements of different areas and to cover activities requiring special attention.

(vi) The responsibility for monitoring and evaluating the implementation of the projects rested with NABARD.

(vii) NABARD was also made responsible for inspection of RRBs and co-operative banks, other than primary co-operative banks, while the licensing powers in respect of these institutions remained with the Reserve Bank.

(viii) RRBs and co-operative banks (other than primary co-operative banks) submitting returns to the Reserve Bank under various sections of the BR Act, 1949, were expected to furnish copies of the respective returns to NABARD, which was accorded powers to call for information or statements from these banks.

As envisaged, NABARD continued to extend softer lines of refinance for investment credit. It helped in farm planning, training manpower to handle rural development projects, extending technical assistance in a few cases to promote entrepreneurial development and facilitating forward integration in several projects in co-ordination with the state governments.

FINANCIAL SUPPORT TO NABARD FROM THE RESERVE BANK

The balance remaining in the NRC (LTO) fund and the NRC (S) fund amounting to ₹ 1,025 crore and ₹ 365 crore, respectively, were transferred to NABARD. The unutilised portion of the two funds aggregating ₹ 630 crore was, however, kept with the Reserve Bank as a non-interest-bearing deposit of NABARD. This sum was released in stages on an annual basis for investment in government securities, as agreed upon between NABARD and the Reserve Bank. The Reserve Bank continued to contribute to these funds. The total contribution by the Reserve Bank to the NRC (LTO) fund and the NRC (S) fund stood at ₹ 2,355 crore and ₹ 630 crore, respectively as at end-June 1987, including the provision of ₹ 300 crore and ₹ 10 crore, respectively for 1986–87. The transfers to the NRC (LTO) fund with NABARD ranged from 23.8 per cent of the Reserve Bank profits in 1981–82 to 36.1 per cent in 1985–86, with the average working out to 31.1 per cent.

GENERAL LINE OF CREDIT TO NABARD

The Reserve Bank sanctioned a general line of credit to NABARD for granting short-term advances to state co-operative banks for specified purposes and to RRBs for working capital limits. A limit of ₹ 1,400 crore was sanctioned for the year 1986–87. In view of improved profitability of NABARD, the lending rate for this line of credit was progressively raised from 5.5 per cent in 1985–86 to 5.7 per cent in 1986–87 and further to 6.0 per cent in 1987–88. The amount contributed by the Reserve Bank to NABARD by way of capital, NRC (LTO) fund, NRC (S) fund and general line of credit worked out to ₹ 3,985 crore as at end-June 1987, forming 53.0 per cent of NABARD's resources.

TARGETS AND ACHIEVEMENTS

A noteworthy aspect of rural credit was the rapid increase in the share of institutional agencies as distinguished from non-institutional sources. According to AIRDIS, the dependence of rural households for cash debt on non-institutional agencies came down from about 93.0 per cent in 1950–51 to 83.0 per cent in 1961, further down to 71.0 per cent in 1971, to reach a low of 39.0 per cent and then to 33.0 per cent in 1981 and 1991, respectively. There was a major thrust on channelising institutional credit to the weaker sections of society in the 1980s. The outstanding credit to the agriculture and allied activities from all agencies increased from ₹ 10,200 crore to ₹ 35,300 crore between 1980–81 and 1988–89, showing an annual compound growth rate of 16.8 per cent. This strongly supported the presumption that the share of institutional credit in total rural credit increased considerably during the 1980s and that the Reserve Bank played a key role in facilitating the institutions to post such a performance.[13]

The Reserve Bank took several policy measures with regard to rural credit which, *inter alia*, included: a credit-deposit ratio of 60.0 per cent to be attained by rural and semi-urban branches of commercial banks; credit planning, co-ordination and monitoring under the lead bank mechanism; structural transformation at the apex and retail levels through the creation of NABARD, RRBs and farmers' service societies; ceding of primary agricultural co-operative credit societies (PACS) to a few commercial banks in areas where district co-operative central banks were weak; standardisation of unit costs of investment to avoid under financing or over financing; and case-by-case analysis of loans to rectify the defects of loan periods and quantum.

The agricultural year 1980–81 witnessed a record index of agricultural production of 135.3, which increased to 158.1 by 1985–86. The total bank

13. Malhotra, R.N. (1990). *India's Monetary Policy and the Role of Banking System in Economic Development*. Address at the 30th National Defence Course. New Delhi. March 12.

credit outstanding to agriculture as a percentage of gross domestic product (GDP) originating in agriculture and allied activities, which increased from 7.8 per cent in 1980–81 to 11.0 per cent in 1985–86, remained at that level until the early 1990s.[14] A few agriculturally developed states, however, accounted for a larger share of rural credit. Five states, namely, Andhra Pradesh, Tamil Nadu, Punjab, Uttar Pradesh and Maharashtra accounted for 45.0 per cent of the total direct agricultural credit in any year. In the state of Uttar Pradesh, it was the central and western parts that received most of the direct agricultural credit and in the state of Andhra Pradesh, the coastal districts and a few Telangana districts got the major share. However, in terms of banking spread, there were fewer imbalances within various regions than across the states.

The Indian banking system played a crucial role in increasing the national savings rate and in channelising the available savings into high-priority investments. Indian banks facilitated better utilisation of available capacities both in agriculture and industry through adequate supply of credit as working capital to promote social justice by placing emphasis on the hitherto neglected sectors and sections of population and by providing finance for anti-poverty programmes, such as the IRDP.[15]

The PSBs cast a network of branches throughout the country, in particular, in rural and semi-urban areas. The rural and semi-urban branches increased from 5,204 as on July 19, 1969 to 43,734 as on June 30, 1989. The number of PSB branches, which stood at 4,160 in the rural and semi-urban centres as on July 19, 1969 increased to 27,226 as on June 30, 1989, registering a sharp five-fold increase, which indicated the liberal policy pursued by the Reserve Bank in expanding the branch network. The pace of growth, however, slowed down during the period 1981–1989. With the emergence of RRBs in the late 1970s and the strengthening of the co-operative sector after NABARD was established, the expansion of commercial banks decelerated during the 1980s.

RRBs, set up exclusively as the common man's bank, expanded rapidly over a period. The total number of RRBs functioning in the country increased from 102 in June 1981 to 196 in June 1989 and their branches

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14. Shetty, S.L. (2002). "Regional, Sectoral and Functional Distribution of Bank Credit: A Critical Review", Paper presented at the workshop on *Financial Liberalisation and Rural Credit in India*. ISI, Kolkata. March.

15. Singh, Manmohan (1984). *Indian Banking System in the Seventh Five Year Plan*. Speech delivered at the founders' day of Bank of Maharashtra. Pune. September 16.

expanded from 3,598 covering 172 districts in 18 states to 14,090 spread over 370 districts in 23 states during the period. But for the Reserve Bank's support in terms of concessions in cash reserve ratio (CRR) and preferential treatment in opening of branches, such massive expansion and extensive reach of RRBs would not have been possible.

The progress of the three-tier expansion in the co-operative credit structure, *viz.*, the state co-operative banks, central co-operative banks and PACS, apart from the state/central LDBs, was rapid in terms of their spread and enhancement of membership in rural and semi-urban areas. At the grassroots level, the membership of PACS increased by more than 59.0 per cent during 1981 to 1989. These institutions assumed a critical position and undertook tasks, which in the pre-nationalisation period might not have been regarded as the legitimate responsibility of a credit institution. In this context, it was felt that transformation in credit deployment was brought about by conscious policy decisions. The switch away from the market mechanism guided by the criterion of maximisation of profits to financing was an important contributory factor in bringing about a dramatic change. The proportion of rural deposits to total deposits shot up from around 6.0 per cent in 1969 to 15.0 per cent in 1987, as a result of policy measures of the Reserve Bank in the 1980s.

To ensure that rural deposits were not used to finance urban credit, the Reserve Bank directed that each rural and semi-urban branch must attain a credit-deposit ratio of 60.0 per cent. Between 1969 and 1987, rural credit as a proportion of total credit outstanding went up from 3.0 per cent to 15.0 per cent. The credit-deposit ratio went up from under 40.0 per cent in 1969 to nearly 70.0 per cent in 1984, and remained above 60.0 per cent until the late 1980s. Fixing the quantum of lending to the priority sector and the rate of interest on the same varied from year to year. These decisions were taken in accordance with the economic policies, the annual budget commitments and indications from the Central Government.

The flow of resources to the priority sector and within these to the weaker sections of society increased during the year 1981–82 and general guidelines were issued to banks to enhance advances to these segments in such a way that these loans constituted 40.0 per cent of the aggregate bank advances by 1985. Further, 40.0 per cent of priority sector finance was earmarked for agriculture and allied activities, so that this segment would account for at least 16.0 per cent of the total credit by 1985. Specific measures were also introduced to ensure that weaker sections within the priority sector received the maximum benefit. The weaker sections[16] were defined and banks were advised to ensure that at least 15.0 per cent of direct advances went to agriculture, and at least 12.5 per cent of their total finance to SSIs flowed to weaker sections by March 1985. Banks were further advised to earmark ₹ 100 crore for housing finance. They were also counselled to pay greater attention to attaining sub-targets in respect of weaker sections of society identified under the new twenty-point programme, small and marginal farmers, SCs/STs and women entrepreneurs. Command area of irrigation projects and financing of infrastructure for successful implementation of the IRDP were other points of emphasis for the purpose of adequate funding.

In 1985, the Credit Planning Cell (CPC) received a reference from the RPCD to examine the possibility of revising priority sector targets and sub-targets, as desired by the Government. The CPC took the stand that 82.0 per cent of banks' resources were pre-empted by statutory requirements, *i.e.*, CRR and statutory liquidity ratio (SLR) reserves at 56.0 per cent including incremental requirements, food credit at 8.0 per cent and priority sector advances at 18.0 per cent. This left banks with only 18.0 per cent of lendable resources[17] to manage the other credit portfolio. The flexibility of banks to further stretch loan provisions for the priority sector was narrowed, as banks were also required to undertake a speedy rectification of any shortfalls in daily maintenance of SLR. The cell was of the view that a further step-up in the overall target for priority sector advances would dilute the concept of priority, as bulk of credit would be deemed as priority. It was, therefore, suggested that in the next few years, the focus should be on effectively attaining already stipulated targets/sub-targets.

It was also reiterated that the issue of revising targets/sub-targets for priority sector had to be viewed from the angle of profitability of banks. In support of this, the cell highlighted the observations of the committee to review the working of the monetary system (Chakravarty Committee):

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16. The weaker sections were defined in the third volume of the RBI history as small and marginal farmers, landless labourers, and borrowers from allied activities with credit limits up to ₹ 10,000. Similarly, in the SSI sector, units and borrowers with credit limits up to ₹ 25,000 were to be treated as weaker sections. Third, the socially weaker sections of society (also known as underprivileged) were, as a class, financially weak, and lacked bargaining power and articulation in getting their grievances redressed.

17. Reserve Bank of India, internal note, CPC, January 1, 1986.

> Credit planning and monitoring by the central bank, and credit budgeting by the larger public sector banks are, therefore, tools which must be employed to ensure the desired allocation of credit, irrespective of the level of target set for money supply in the light of macro-economic considerations by making use of monetary targeting techniques. Again, the special features of credit extension to the preferred sectors and the complex institutional arrangements necessitated by the nature and magnitude of the task would call for major modifications in the operational and policy framework within which the traditional instruments of monetary policy are generally expected to be used.

The Chakravarty Committee stressed the need for co-ordination between banks and the government agencies for successful implementation of programmes for priority sector lending and improving the recovery of dues. During 1985–86, SCBs achieved the stipulated target of 40.0 per cent for priority sector advances. The data for 50 SCBs, which accounted for 95.0 per cent of gross bank credit, showed that loans to the priority sector had recorded an expansion of ₹ 3,175 crore during 1985–86 (April–March), raising the share of such advances in net bank credit to 40.9 per cent as at end-March 1986 as compared with 39.8 per cent achieved in the previous financial year. As at end-March 1986, the share of finance to agriculture and SSIs in total priority sector credit also increased marginally to 42.0 per cent and 36.2 per cent, respectively. A year before, the respective percentage shares were 41.6 per cent and 35.9 per cent.

The government policy in the 1980s towards rural credit continued to be liberal and, as indicated in an earlier section, the thrust on eradicating poverty, reducing inequality of income through the development of agriculture, providing employment opportunities and uplifting weaker strata of the society was explicit in the budget speeches of the respective Finance Ministers during the period 1982–83 to 1988–89. The sustained expansion in bank credit in real terms for agriculture, SSIs and other informal borrowers during the latter half of the 1970s and the decade of the 1980s served, *inter alia,* as an important factor in acceleration of growth rates in agriculture and unregistered manufacturing. Similarly, acceleration in employment growth from 1.5 per cent per annum during the period 1977–1983 to 2.7 per cent during 1983–1994 and, more significantly, the non-farm employment growth in rural areas that showed outstanding performance in the 1980s, appeared to have been brought about by better sectoral, regional and size distribution of bank credit. Overall, rural branch expansion appeared to be an important causal factor, which helped the Indian economy pierce through the low rate of growth of 3.5 per cent during the three decades after independence and attain a growth rate of 5.5 per cent per annum in the 1980s. On a substantive plane, this was explained by various policy interventions during the period, such as the IRDP bank lending for priority sector, the progressive taxation system and greater involvement of the public sector in development programmes.

In September 1987, in a meeting of the chief executives of PSBs, the Minister of State for Finance, while expressing satisfaction over the achievements of the banking system asked banks to do much more in implementing anti-poverty and employment promotion programmes. He also called on bank chiefs to motivate their staff to provide a helping hand to weaker sections of the community with a sense of devotion and commitment, since people had great expectations from them.

Apart from improving banking facilities in rural and semi-urban areas, banks continued their efforts to reduce disparities in credit-deposit ratio across regions. For the banking system as a whole, credit-deposit ratio for rural branches improved from 62.5 per cent in June 1984 to 65.6 per cent in June 1985. In the case of semi-urban branches also, the credit-deposit ratio improved to 52.8 per cent from 50.9 per cent the year before.

During 1987–88, PSBs continued to meet the targets and sub-targets fixed for priority sector advances and stepped up lending under special schemes. The proportion of priority sector advances of PSBs to total outstanding bank credit registered an increase from 44.1 per cent as at end-December 1986 to 45.7 per cent as at end-June 1988. PSBs achieved the target of extending 10.0 per cent of their total advances (or 25.0% of their priority sector advances) to weaker sections. They not only complied with the requirement of lending at least 16.0 per cent of their total credit as direct advances for agriculture as on March 1987 but also almost reached the level of 17.0 per cent required to be maintained by March 1989. The 28 PSBs extended financial assistance under the twenty-point programme to the tune of ₹ 8,855 crore under approximately 190 lakh borrowers' accounts as on the last Friday of March 1988, constituting 31.1 per cent of their total priority sector advances or 14.3 per cent of their total bank credit.

Lending under the differential rate of interest (DRI) scheme for PSBs made considerable progress and exceeded the prescribed targets well ahead of schedule. Credit disbursal up to June 1984 constituted 1.1 per cent of aggregate advances as at the end of the previous year, thus exceeding the target of 1.0 per cent. The coverage of DRI scheme in respect of SC/ST borrowers also expanded beyond expectations with 49.4 per cent of total advances going to them against a target of 40.0 per cent during the year 1984. The number of accounts covered under the scheme increased from 27 lakh as at end-June 1981 to 47.7 lakh as at end-March 1989, and the amount of loan outstanding in these accounts, which was ₹ 598 crore in December 1987, increased to ₹ 680 crore at end-March 1989. The extent of involvement of SCBs in financing the priority sector is reflected in Table 8.4.

TABLE 8.4

Position of Priority Sector Advances of SCBs

(₹ crore)

Year	*Agricultural Advances*	*Total Priority Sector Advances*	*Net Bank Credit*
June 1982	4,594 (43.0)	10,673 (37.0)	28,821
June 1983	5,375 (42.5)	12,637 (36.8)	34,298
June 1984	6,551 (41.2)	15,894 (38.4)	41,378
June 1985	7,978 (41.5)	19,208 (40.0)	48,050
June 1986	9,391 (42.1)	22,302 (41.8)	53,381
June 1987	10,852 (41.8)	25,980 (43.2)	60,104
June 1988	12,285 (41.2)	29,845 (44.0)	67,792
June 1989	14,133 (40.1)	35,242 (42.4)	83,192

Notes: 1. Data relate to 50 SCBs which account for about 95.0 per cent of gross bank credit.
2. Net bank credit data are exclusive of bills rediscounted with the Reserve Bank, Industrial Development Bank of India (IDBI), Exim Bank and other financial institutions (OFIs).
3. Under agriculture: figures in parentheses indicate percentage share to total priority sector advances.
4. Under priority sector advances: figures in parentheses indicate percentage share to net bank credit.

Source: Reserve Bank of India, *Trend and Progress of Banking in India*, various issues.

During 1988–89, PSBs continued to exceed targets and sub-targets fixed for priority sector finance. The proportion of priority sector advances of PSBs stood at 44.6 per cent of the net bank credit as at end-June 1989, which was higher than the prescribed target of 40.0 per cent. Similarly, the proportion of PSBs' credit to weaker sections was 11.1 per cent of their total outstanding resources disbursed as loans as at end-

June 1989 as against a target of 10.0 per cent. The share of credit to SCs and STs in priority sector advances stood at 7.6 per cent at the end of the above period. The PSBs provided financial assistance under the twenty-point programme to the tune of ₹ 11,270 crore in approximately 230 lakh borrowers' accounts on the last Friday of June 1989, constituting 32.3 per cent of their total priority sector lending or 14.4 per cent of the net bank credit. Under the DRI scheme, the outstanding credit as at end-June 1989 was ₹ 665 crore, which constituted 0.9 per cent of their total outstanding loans. The resources granted under the scheme to beneficiaries belonging to the SC/ST also exceeded the prescribed target of 40.0 per cent of DRI advances.

Advances to priority sector by Indian banks in private sector as at end-June 1988 constituted 39.8 per cent of their total loans; their direct finance to agriculture formed 9.1 per cent of the total sum lent, while those to weaker section constituted 5.2 per cent of their total advances. The DRI advances formed only 0.4 per cent of the total credit extended as against the target of 1.0 per cent. In August 1988, foreign banks were advised that their priority sector advances should reach a level of 10.0 per cent of their aggregate outstanding credit by end-March 1989. This target was increased to 12.0 per cent and further to 15.0 per cent by end-March 1990 and end-March 1992, respectively.

Yet another area of banks' involvement was the special foodgrains production programme (SFPP), which was a two-year programme implemented in 169 'thrust districts' in 14 states from the 1988 *kharif* season. Under this programme, commercial banks provided credit of the order of ₹ 352 crore.

The credit-deposit ratio of SCBs increased to 60.1 per cent at end-June 1989 as against 57.3 per cent the year before. The credit-deposit ratio of rural branches of all commercial banks stood at 64.3 per cent at end-December 1988, which was well above the stipulated target of 60.0 per cent. The rural branches of PSBs had attained a credit-deposit ratio of more than 60.0 per cent in as many as 14 states/UTs; however, the ratio in their semi-urban branches was around 50.0 per cent as against the envisaged level of 60.0 per cent. The economic profile of semi-urban areas with a predominance of trading and service activities, which had less potential for bank lending but generated relatively larger deposits, explained this persistent low level of credit-deposit ratio in those areas.

REGIONAL RURAL BANKS

RRBs, established in the late 1970s as the common man's bank, made rapid progress in terms of branch expansion, deposit mobilisation and dispensation of credit to the desired sectors and sections of society. The steering committee on RRBs identified additional districts for setting-up RRBs and as a result, 183 RRBs were established as against the target of 170 to be achieved by 1985. During the period 1985–87, 13 more RRBs were established taking the total number to 196, covering 354 districts as at end-April 1987, and the number stood at that since then.

Based on the recommendations of the working group on the development of scheduled castes and scheduled tribes in September 1982, RRBs were asked to formulate their credit plans, taking into account the needs of these communities and to draw up special bankable schemes to ensure a large flow of credit to them for self-employment. The banks were encouraged to consider loan proposals from such communities favourably.

A field study on quality of lending by RRBs conducted in the early 1980s revealed, *inter alia*, that the basic aim of setting-up RRBs was largely achieved and that they had successfully maintained their image as a small man's bank by confining their credit facilities to the target group.

In 1987, the Government set up a working group chaired by Shri Kelkar to examine the structure of RRBs and suggest measures to improve their overall capabilities. The recommendations, which were accepted included, *inter alia*, to increase the paid-up capital from ₹ 25 lakh to ₹ 100 lakh; sponsor banks should reduce the lending rate for refinance to RRBs from 8.5 per cent to 7.0 per cent; allow RRBs to invest their surplus funds in government and other trustee securities instead of keeping them in current account with the sponsor banks in order to improve their profitability; and sponsor banks should play a more proactive role in funds management, staff training and internal audit of RRBs. The committee recommended that these banks should abstain from financing bigger borrowers so as to retain their stature of the small man's bank.

As at end-June 1986, nearly 80 RRBs had a recovery rate of less than 50.0 per cent, and as many as 150 RRBs were posting losses, which amounted to ₹ 90 crore. In the case of 49 RRBs, the accumulated losses had used up their entire share capital. A number of RRBs were also unable to comply with the statutory requirements in respect of liquidity and cash reserve maintenance.

CRAFICARD had recommended that RRBs should continue their operations to support weaker sections. Earlier, the Dantwala Committee (1978) had termed RRBs as an integral part of the rural credit structure, and considered routing the credit through the PACS, thereby strengthening them. The agricultural credit review committee under the chairmanship of Shri A.M. Khusro, constituted in August 1986, submitted its report in August 1989. The committee came out with critical observations and made far-reaching recommendations in this context.[18] In the case of RRBs, the Khusro Committee concluded that there was no place for RRBs in the rural credit system and that they should be merged with the sponsor banks. It was emphasised that the merger recommendation did not mean any dilution of concern for the common man. On the contrary, the intention was to give the common man a stronger institution to serve his needs more efficiently. The objective was to ensure service to the poor and not poor service.[19]

DEVELOPMENTS IN CO-OPERATIVE CREDIT

REORGANISATION OF PACS

Recognising the need for a strong and viable base-level co-operative structure as an important prerequisite and to make co-operatives an effective channel for purveying rural credit, the Reserve Bank continued efforts in this direction through the 1980s. The state governments were urged to complete the reorganisation of primary-level institutions expeditiously. Barring three states, *viz.*, Gujarat, Maharashtra and Jammu & Kashmir, all the others had more or less completed the re-organisation programme.

STUDY GROUP ON FINANCING OF PACS BY COMMERCIAL BANKS

The study group on financing of PACS by commercial banks submitted its Report in August 1981. The findings revealed that this arrangement had failed to achieve its major objectives and did not make a perceptible impact on the functioning of such societies associated with commercial banks. The group, therefore, felt that no useful purpose was served by continuing with this arrangement. The agricultural credit board (ACB)

18. Appendix 8.1 provides a summary of the observations and recommendations of the Khusro Committee.

19. Khusro Committee report, p.935.

considered the report and recommended that it should be left entirely to the concerned societies to decide whether they preferred to continue their links with the commercial banks or wanted to be transferred back to the district central co-operative banks to which they were affiliated.

STUDY ON DEPLOYMENT OF RESOURCES BY STATE AND CENTRAL CO-OPERATIVE BANKS

A study group was constituted on deployment of resources by the state and central co-operative banks in March 1981 to examine the problem of surplus resources and profitable investments of lendable internal resources. The report of the group submitted in August 1981, made recommendations for profitable deployment of resources. In light of these recommendations, the Reserve Bank issued guidelines to state co-operative banks, advising them of avenues to deploy their surplus resources.

STANDING COMMITTEE ON TERM LENDING THROUGH CO-OPERATIVES

The Reserve Bank appointed a standing committee on term lending through co-operatives (COTELCOOP) in November 1981 under the chairmanship of a Deputy Governor to review, on a continuing basis, the operations, policies and procedures of land development banks (LDBs).[20] The terms of reference of the committee included: to review the organisational capabilities of LDBs in the context of project lending and prompt recycling of resources; to examine the loan policies and procedures of LDBs, and provide guidance for their rationalisation and improved financial management; to review the recovery performance of LDBs; to formulate a time-bound rehabilitation programme for weak LDBs and monitor its implementation; to review the norms for fixing the lending programme of LDBs; and to bring about functional co-ordination between LDBs and PACS in order to ensure sound growth of SLDBs. In light of the reports submitted by expert groups, which examined measures for improving the overall organisation, management and finance of LDBs in six states, *viz.*, Tamil Nadu, Karnataka, Bihar, Madhya Pradesh, Gujarat and Maharashtra, the committee communicated to these state governments various measures that they should adopt to improve the overall operational efficiency of the primary LDBs/branches of the SLDBs.

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20. Reserve Bank of India, *Annual Report, 1981-82.*

OTHER DEVELOPMENTS

The Reserve Bank communicated to the state co-operative banks various areas covered in the new twenty-point programme where the banks could play a meaningful role. These included financing of minor irrigation schemes; provision of credit to bring more areas under intensive cultivation of pulses and vegetable oilseeds; provision of full finance for various schemes under the IRDP, particularly to SCs/STs so as to alleviate their poverty; financing of co-operatives engaged in distributing essential commodities in order to build a strong consumer movement and make available the necessities to the common man at competitive prices by eliminating the middlemen; and encouraging handloom weavers and other rural artisans to set up co-operatives by providing adequate credit to ensure continuous gainful employment.

The Khusro Committee remarked on the performance of the co-operative system and stated: "Co-operation has failed in India because it has been state-sponsored and state-patronised." The excessive state intervention in the affairs of co-operatives rendered the leadership ineffective and democratic management of co-operatives unsuccessful. The committee noted that a major weakness of the system was the neglect of base-level institutions and the tendency of high level institutions to look after their own interests, often at the cost of the primaries. Further, "The co-operative credit system had failed miserably in executing its basic responsibility towards mobilising deposits, with the lower tiers looking up to the higher tiers for refinance at all levels. Progressive politicisation had caused extensive damage to the system and had reached such immense proportions that unless the trend was reversed, the agricultural credit system and the co-operative credit system, in particular, would get seriously jeopardised." The committee recommended the setting-up of a National Co-operative Bank of India (NCBI) as well as a separate corporation to implement the crop insurance scheme.

SPECIAL SCHEMES AND PROGRAMMES

During the period, there was a continued interplay between the Government and the Reserve Bank in harmonising regulatory guidelines to banks and aligning them with the Government's schemes and programme objectives. The Government, in consultation with the Bank, regularly monitored these developments and brought in necessary changes to improve programme effectiveness.

INTEGRATED RURAL DEVELOPMENT PROGRAMME

The IRDP was introduced in the mid-1970s to improve the lot of the poorest of the poor. The official review in 1981 established that the progress in the disbursal of institutional credit under this programme was not satisfactory and the Reserve Bank had to issue fresh guidelines in December 1981 to all the operational agencies to gear up their machinery to achieve stipulated annual targets. This was followed by a meeting of the Governor with the chief executives of PSBs in February 1983. Banks were asked to ensure that effective action was taken to meet their targets and to monitor the end-use of funds to realise the programme objectives. They were advised to issue loan passbooks to IRDP beneficiaries to apprise them of the exact amount of the loan, the amount outstanding and the period of repayment; to strictly comply with the guidelines on additional security for small loans; to appoint staff with the necessary aptitude, skills and expertise; to finalise repayment schedules in a realistic manner; and to fix the repayment period taking into account factors such as repayment capacity and the life of the asset created from the loan amount.

The Reserve Bank advised the lead banks in July 1984 to ensure that they actively organised workshops in their lead districts to train bank personnel (commercial and co-operative) as well as government officials at the district level. During the Sixth Plan, 16.6 million families were assisted under the programme against the target of 15.0 million families, and term-credit to the tune of ₹ 3,102 crore was disbursed. However, since evaluation reports on implementation of IRDP by various agencies indicated that 60.0 per cent of the assisted families were unable to cross the poverty line, a scheme to provide supplementary assistance to certain eligible categories of borrowers assisted during the Sixth Plan was initiated in 1985–86, besides covering new beneficiaries. The supplementary assistance was extended to help borrowers who were not defaulters and had either maintained the financed assets in good condition or lost them for reasons beyond their control. The central sector outlay for the programme was ₹ 1,187 crore. A target of 20.0 million families was set for assistance under the IRDP during the Seventh Plan period. This included 10.0 million families who were assisted during the Sixth Plan but could not cross the poverty line and were to be given a second dose of assistance. The banks extended assistance to 11.1 million families during the first three years of the Seventh Plan. Of the beneficiaries, 4.9 million belonged to SCs/ STs and 1.2 million were women.

The Government issued fresh guidelines for the implementation of the IRDP during the Seventh Five Year Plan, revising the poverty line from an annual family income of ₹ 3,500 to ₹ 6,400. However, for identifying the families, a lower cut-off point was fixed, *i.e.*, an annual income of ₹ 4,800. Further, in view of interstate variations and disparities in the incidence of poverty, it was decided to allocate funds under the IRDP in relation to the incidence of poverty in each state. A separate target of 30.0 per cent was fixed to cover women beneficiaries.

A study group was set up by the Reserve Bank in November 1985 under the chairmanship of Shri A. Ghosh, Deputy Governor, to streamline the arrangements for flow of credit and supply of inputs and assets to the IRDP beneficiaries so that they could draw full benefits of the anti-poverty programme. Banks were advised to implement, on an experimental basis, a system of cash disbursement of the IRDP assistance for specified purposes in 22 selected blocks all over the country effective April 1, 1986. The achievements under the programme are highlighted in Table 8.5.

The Government's concurrent evaluation of assistance provided under the IRDP on a continuous basis, beginning October 1985, found several irregularities in implementing the scheme, such as, accommodating ineligible borrowers, excluding eligible borrowers, inordinate delays in sanctions, concentration of the scheme in one or two categories as against the directives to cover wider segments and non-adherence to the selection process. Banks were advised to arrange crash training programmes for officers in rural branches at the district level to familiarise them with the instructions/guidelines relating to bank finance for special programmes like the IRDP.

TABLE 8.5

Achievements under the IRDP

(Lakh)

	1985–86	*1986–87*	*1987–88*	*1988–89*	*1989–90*
No. of families assisted	30.6	37.5	42.5	37.7	33.5
No. of SC/ST families	13.2	16.8	19.0	17.5	15.4
No. of women beneficiaries	3.0	5.7	8.3	8.7	8.6

Source: Reserve Bank of India, *Trend and Progress of Banking in India*, various issues.

THE NEW TWENTY-POINT PROGRAMME

After the Prime Minister announced the new twenty-point programme[21] in January 1982, the Reserve Bank appointed a working group chaired by Shri A. Ghosh, Deputy Governor, in March 1982, to formulate the modalities of implementing the programme. The group was to identify the tasks for the banking system. The other terms of reference were to review the targets and sub-targets within the priority sector with specific reference to the needs of weaker sections; to examine the scope for modifications in the definition of the priority sector; and to review the reporting and monitoring system regarding the flow of credit to the new programme with a view to simplifying and expediting flow of information and making evaluation more effective.

The group identified the beneficiaries and the type of assistance, which could be rendered. The group also stressed the need to ensure that the schemes for the beneficiaries were viable and that there was effective co-ordination between the state governments and banks.

The Reserve Bank accepted the recommendations of the working group on the role of banks in implementing the new programme, with some modifications. Banks were accordingly urged to draw up detailed operational plans to achieve various targets and to assess their performance *vis-à-vis* the overall priority sector target; attention was drawn to the sub-targets in respect of direct finance to agriculture (15.0% of total credit to be attained as at end-March 1985 and 16.0% as at end-March 1987) and advances to weaker sections (10.0% of total credit to be attained at end-March 1985).

The amount of ₹ 100 crore earmarked by banks for housing finance during 1982–83 was raised to ₹ 150 crore. Banks were advised to pay greater attention to the attainment of sub-targets for weaker sections of society as identified under the new Programme, the credit needs of small and marginal farmers, SC/ST categories, women entrepreneurs, command areas of irrigation projects, banking infrastructure for successful implementation of the IRDP and quality and promptness of customer service.

Target groups of beneficiaries under the new programme were also identified within the priority sector. The scope of advances to priority sector

21. The third volume of the Reserve Bank's history refers to the twenty-point programme that was conceived to assist specific economic activities in villages and rural areas.

was widened to cover housing loans for SCs/STs and economically weaker sections and also to cover consumption loans under the programme. The banks were asked to pay special attention to providing assistance to beneficiaries within the district credit plans (DCPs). The lending procedures of the banks were simplified further to ensure that small loan applications were disposed of within three to four weeks. Security and margin requirements were relaxed for this purpose; for example, banks were to take only demand promissory notes for crop loans of up to ₹ 1,000. For artisans, craftsmen and village and cottage industries, banks were asked not to insist on securities other than hypothecation of assets. Moreover, the IRDP was extended to all blocks with a view to providing greater financial assistance to weaker sections of society.

The PSBs extended financial assistance amounting to ₹ 5,531 crore under the new programme as at end-March 1985, covering 115 lakh accounts.

LEAD BANK SCHEME

The Reserve Bank set up a working group chaired by Shri U.K. Sarma, Executive Director, in November 1981, as per the recommendations of CRAFICARD to review the working of the LBS. The terms of reference of the group included, *inter alia,* to review the working of the LBS in preparing and implementing DCPs and to suggest, in light of recommendations of CRAFICARD, improvements for proper and effective co-ordination of activities among the participating organisations; to review the role of the lead banks and suggest measures to make them more effective; to advocate ways to improve the organisational structure of lead banks and non-lead banks at the district and other levels; and to examine the role of district consultative committees and standing committees and make suggestions for their effective functioning. The recommendations were accepted, *albeit* with modifications, for implementation in 1982.

As per the instructions issued to state governments and commercial banks, DCPs for 1983–1985 and annual action plans (AAPs) for 1983 were prepared and launched in all the districts, except for a few in the north-eastern region. The AAPs for 1983–84 were also finalised for most districts. The third round of DCPs ended in March 1985.

Pending a decision on the coverage of the fourth round of DCPs under the Seventh Five Year Plan, the AAP for 1985 was finalised and launched in all the lead districts, except for a few in the north-eastern region. In September 1984, the Reserve Bank issued guidelines to banks to ensure integration of targets under the AAP outlays and performance budgets of bank branches.

The Government set up a working group under the chairmanship of Shri A.K. Agarwal, Joint Secretary, Banking Division, Ministry of Finance in March 1985 to review some aspects of the LBS and suggest measures to make the scheme more effective and result-oriented. The terms of reference included, *inter alia,* examining the role of various forums at the block/district/state levels and suggesting a more rational framework for such three-tier committees.

Pending finalisation of the guidelines for the fourth round of DCPs, lead banks were advised to prepare the AAPs for the subsequent years and, accordingly, the AAPs for 1986 (except for three districts in Nagaland) and 1987 were prepared and launched for implementation in all districts of the country.

As at end-December 1987, the LBS covered 438 districts in the country. According to the guidelines, the preparation of DCPs for 1988–1990 (fourth round) and the AAPs for 1988 were complete and the plans were implemented in all the districts. The achievement under the AAPs for 1987 was ₹ 10,940 crore as against ₹ 10,110 crore under similar plans for 1986.

At this point, a question was raised regarding the effectiveness of the Lead District Officers (LDOs). There were representations from various quarters that the status of the LDO did not give him sufficient authority to co-ordinate with other banks and government officials, and it was suggested that his rank should be elevated to at least that of an assistant general manager (AGM). The Reserve Bank, however, did not consider it necessary to upgrade the status of the LDOs.

The performance of the United Bank of India (UBI) was not considered satisfactory and there was a demand to change the lead bank in the state of Assam to the State Bank of India (SBI). The Reserve Bank, however, decided not to bring in any change in view of the pattern of branch network and lending by these banks in the state. The UBI was, against this backdrop, advised to shore up its delivery capabilities in the state.

In the context of the implementation of the LBS, the position of banks and branches in the 1980s was very vulnerable. No event could take place in such offices without the participation of a Member Parliament (MP) or the local Members of Legislative Assembly (MLAs). The local MP had to be invited even for opening of a branch and he had to be involved in all district level review committee (DLRC) meetings of banks. In one case where a branch was opened without inviting the local MP, the MP took up the matter with the Ministry of Finance, stating that the bank authorities were not following the instructions of the Government regarding the issue of loans to the grieved persons under the government schemes and also for various functions conducted by them. It was further emphasised that the MPs should be invited for all the functions.[22] The Reserve Bank was asked to offer its comments by the finance ministry.[23] On the basis of the decision taken by the Central Government, the Reserve Bank advised the regional offices of RPCD to issue necessary instructions to the convenor banks that local MLAs/MPs were to be invited to all the DLRC meetings.

In several states there were demands from political quarters to put in place the above arrangements. The Reserve Bank had on an earlier occasion permitted inviting non-officials to cover principal groups of beneficiaries of bank credit in cases where activity/occupation was central to the district economy. The matter of inviting MPs and MLAs for the DLRC meetings was discussed internally and views of the concerned officials from the states were also considered. In this context, it was observed:[24]

> The attitude of the elected representatives of people has generally a political bias and very often considerations other than economic and social are reflected in the views aired by them. By throwing open the doors of the DLRCs to MPs and MLAs, we feel that the entire LBS will be gradually politicised and the day will not be too far when entry will have to be allowed to politicians into DCC meetings as well. Further, the question as to whether elected representatives of people could represent any principal group of beneficiaries of bank credit central to the economy of the district is a debatable issue. Our experience in associating a cross-section of non-officials other than politicians with DLRC meetings has been generally satisfactory.

Subsequently, the Government decided that all local MPs and MLAs should be extended invitation to attend DLRC meetings. There was, however, disagreement in the Reserve Bank top management on the issue. In this context, Dr P.D. Ojha, Deputy Governor noted:[25]

22. Letter dated June 15, 1989 from Shri C.K. Kuppuswamy, MP, Coimbatore.
23. File No.PL 09.02 RPCD, guidelines on advances to priority sector, Reserve Bank of India.
24. Letter from District Co-ordinating Office (DCO), Thiruvananthapuram dated January 7, 1989 to RPCD Central Office.
25. Reserve Bank of India, internal note dated March 1, 1989.

> As per our present policy, non-officials are allowed to be invited to attend the District Level Review meetings convened by lead banks. There is no need to change it. Village *panchayats*/local MLAs/MPs having special knowledge of the activities of the areas can be associated with the meetings of District Level Reviews. District Consultative and Block-level Bankers' committees should be business-like and only officials should be associated with these as at present.

The Governor, Shri R.N. Malhotra, expressed that the proposed instructions were vague. He observed that "we should instruct that at the meetings of DLRC, MPs and MLAs of the district should be invited."[26] Accordingly, the Reserve Bank issued a circular to the chairmen of all lead banks on April 13, 1989, instructing them to invite all local MPs and MLAs to DLRC meetings in future.

SERVICE AREA APPROACH

The SAA, introduced in 1988, was expected to contribute to orderly and planned development of credit in identified service areas (a group of contiguous villages) of each rural/semi-urban branch of commercial banks and RRBs. The approach was intended to help intensify supervision of end-use of credit and recovery of loans. The scheme was also expected to assist in harmonising the efforts of banks in providing credit for rural development activities with those of co-operative institutions and other development agencies and avoid diffusion of efforts. The Reserve Bank instructed banks to adopt this new approach early. The process of identifying service areas and allocating villages to each branch, which was the first stage of implementation, was largely completed by June 30, 1988. The service area of each branch normally comprised 15–25 villages but could vary from state to state. At the next stage, the respective branches took up a potentiality survey of the service area and formulated credit plans on an annual basis. Other basic features of this system of lending were systematic implementation of credit plans along with a mechanism for continuous monitoring of progress, avoiding duplication of efforts and co-ordinating with other institutional agencies that provided non-credit inputs. A country-wide training programme was launched to ensure that the new approach was made effective. Instructions were issued to avoid disruption of credit flow during the transition period.

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26. Reserve Bank of India, internal note dated March 9, 1989.

The basic objective of the SAA, which became operational effective April 1, 1989, was to make rural lending more productive and purposeful. As at end-June 1989, credit plans were prepared by all 42,000 branches covering 6 lakh villages. The annual branch credit plans were grouped into block credit plans, which in turn were regrouped into the DCPs. To conform to the norms prescribed under this system, additional licences were issued to banks (including RRBs) to open branches at 1,416 out of 3,049 identified centres up to November 1989. Block-level bankers' committees were constituted for effective co-ordination among credit institutions and with field-level development agencies. The new system was expected to lead to distinct improvement in the quality of rural lending and help forge better links between bank credit, productivity and income levels.

In the mid-1980s, when the loan *melas* reached a feverish pitch, the Reserve Bank defined the service area for each branch, which helped bankers withstand the pressure of indiscriminate lending. The move, however, invited the displeasure of the Government, as per a media report released at a later date.[27]

DIFFERENTIAL RATE OF INTEREST SCHEME

The DRI scheme was introduced in June 1972. Under this scheme, banks were to provide credit at a very low rate of interest of 4.0 per cent per annum to the weakest among the weaker sections of society to enable them to improve their income levels and economic conditions through productive endeavours on a modest scale. The scheme was reviewed periodically and modifications were made therein, in order to maintain consistency with the social and economic objectives in raising the share of poorer sections in national income, consumption and utilisation of public services. Such specific action programmes designed essentially to assist in eliminating unemployment and poverty, were in focus during the 1980s also and the Reserve Bank placed special emphasis on such endeavours in conformity with government policies and priorities.

A study by the National Institute of Bank Management[28] (NIBM) showed that the DRI scheme had penetrated into a large number of small and far-flung areas in the country and had made the common man conscious of the efforts being made collectively by the Government and

27. *The Economic Times*, May 6, 2010.

28. Chawla, O.P., K.V. Patil and N.B. Shete (1983). "Impact of Differential Rate of Interest", *NIBM Faculty Occasional Papers* (Book Review). December. p.214.

banks for his economic upliftment. The proportion of DRI advances by banks to total credit touched 1.2 per cent in December 1981, thereby exceeding the target of 1.0 per cent set under the modified DRI scheme. The coverage of SCs and STs under the scheme also improved; the share of these categories of borrowers in total DRI advances of banks was 47.9 per cent in 1981 as compared with the target of 40.0 per cent. Further, 73.2 per cent of the banks' DRI advances in 1981 were channelled through their rural/ semi-urban branches as compared with the target of two-thirds fixed for advances in these areas.

Nevertheless, the NIBM study highlighted some disturbing features in the working of the DRI scheme. It was found that many people were not aware of the DRI scheme or its benefits for borrowers. Further, many ineligible borrowers had managed to secure loans under the DRI scheme by understating their family incomes. In a large number of borrowers' accounts, there was a mismatch between the loan amount sanctioned, the amount actually needed for the activity, the loan terms and the periodicity of repayments, thus sowing the seeds of borrower delinquency and non-fulfilment of the DRI objectives right from the beginning.

The DRI scheme was extended to include private sector banks so that its coverage could be widened to the entire country. Private sector banks were directed to ensure that at least two-third of their advances under this scheme were routed through their rural and semi-urban branches. The scheme was also modified to allow banks to route such advances through RRBs on a refinance basis.

COMPREHENSIVE CROP INSURANCE SCHEME

From the 1985 *kharif* season, the Government introduced a comprehensive scheme for crop insurance throughout the country, covering major crops, *viz.*, rice, wheat, millets, oilseeds and pulses. The scheme was to operate in the defined areas for each crop as notified by the Government. The scheme was intended to cover all the farmers availing of crop loans from co-operative credit institutions, commercial banks and RRBs to raise these crops, and insurance cover was built in as part of the loan. The sum insured was 150.0 per cent of the amount of loan disbursed and the insurance premium was included in the scale of finance for the crop loan. The Reserve Bank advised commercial banks to participate actively in the scheme.

Initially, the scheme was implemented in states where the state governments agreed to implement the same. During the 1988 *kharif* season, the scheme was implemented in 13 states and 2 UTs. The Government decided subsequently that the comprehensive crop insurance scheme (CCIS) be continued in the 1988–89 *rabi* season only in states where premia towards the scheme had already been recovered.

CREDIT TO MINORITY COMMUNITIES

In line with the Prime Minister's fifteen-point programme for the welfare of minority communities, the Reserve Bank advised all banks in July 1986 to take steps to facilitate the flow of adequate credit to minority communities. These included setting-up of special cells to look after minorities' interests in areas that had a large concentration of minority communities, conducting periodic reviews of steps taken as well as progress made and publicising anti-poverty programmes in such areas with a large population of minorities.

As at end-December 1987, priority sector advances by PSBs to minority communities in 40 identified districts amounted to ₹ 429 crore with 8 lakh borrowal accounts. All PSBs set up special cells at their head offices and at the lead banks of the identified districts and designated one officer in each to exclusively look after various aspects of credit flow to minority communities.

CREDIT FACILITIES TO SCHEDULED CASTES AND SCHEDULED TRIBES

In the context of the discussions held in the meeting of the parliamentary committee on the welfare of SCs/STs in early 1983, it was considered necessary for all commercial banks to assess, at periodic intervals, the implementation of the guidelines issued by the Reserve Bank by their branches. The Reserve Bank advised all banks in August 1983[29] that:

(i) A special cell should be set up at the head office to monitor the flow of credit to SC/ST beneficiaries. The cell should collect relevant information/data from the branches, consolidate them and submit the requisite returns to the Reserve Bank and the Government.

(ii) The board of directors of the banks should review, on a quarterly basis, the measures taken to enhance the flow of credit to SC/ST borrowers.

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29. Reserve Bank of India, RPCD circular no. PS.BC.4/C.594-83 dated August 22, 1983.

(iii) The board should consider the progress made in lending to these borrower categories directly or through state-level SC/ST corporations based, among others, on field visits by senior officers from the head office/controlling offices. In January 1984, all commercial banks were advised that if SC/ST applications were to be rejected (under IRDP or other programmes), it should not be done at the branch level but at one higher level. A cell was set up in the RPCD of the Reserve Bank to exclusively monitor credit flow to SCs/STs.

The Reserve Bank advised all banks to step up their lending to SC/ST beneficiaries, making greater use of the state-level corporations set up for the welfare of such beneficiaries. The progress made by PSBs in lending to SC/ST members out of priority sector advances during the period 1986 to 1988 showed that both in terms of number of borrowal accounts and outstanding amount, advances to SC/ST categories had increased.

The parliamentary committee on welfare of SCs/STs (8th Lok Sabha) had desired that the LDOs of the Reserve Bank should visit some loanees, especially the SC/ST loanees, to assess their difficulties in securing loans. The Reserve Bank accepted the recommendation and the LDOs were instructed to contact SC/ST loanees during their visits to rural branches of banks.

The Ministry of Finance apprised the RPCD[30] that it had been brought to the Prime Minister's notice that nomads were not entitled to bank loans for self-employment activities. The RPCD was asked for its comments on the suggestion that suitable means needed to be devised to provide nomads access to bank finance. The RPCD in its reply on February 27, 1989 informed the finance ministry that it was difficult for banks to provide credit assistance to nomads, who did not have any fixed place where they could be contacted. The reply also stated that extending bank finance could be considered to nomads who had some fixed base for at least a major part of the year.

Further, in April 1989, the finance ministry, indicated to the Reserve bank[31] that the Prime Minister's Office (PMO) desired that specific instructions be issued to all PSBs to provide bank finance for productive activities to nomads who had some fixed base for at least a major part of

30. Telex from the Ministry of Finance to RPCD, Reserve Bank of India, February 22, 1989.
31. Telex from the Ministry of Finance to RPCD, Reserve Bank of India, April 1989.

the year and that the PMO wanted to have a report on the matter by May 1, 1989. Accordingly, a circular was issued on May 4, 1987 to this effect by the Reserve Bank.[32]

SELF EMPLOYMENT SCHEME FOR EDUCATED UNEMPLOYED YOUTH

This scheme, introduced in September 1983, aimed at encouraging educated unemployed youth to undertake productive self-employment ventures. The target of beneficiaries to be assisted was fixed at 2.5 lakh per annum. In August 1985, the Reserve Bank instructed SCBs to consider credit proposals recommended by the district industries centres (DICs), district rural development agencies, and *khadi* and village industrial centres, so that young men and women trained by the vocational guidance units could take up self-employment projects in agriculture, horticulture, animal husbandry, fisheries and forestry as well as in small and village industries including agro-processing.

The Government initiated various schemes to provide assistance for the development of the rural sector. Some of these were contributions through budgetary provisions to the agricultural credit stabilisation fund maintained at the level of the apex co-operative bank, risk fund for consumption credit, cadre fund of the reorganised base level credit institutions and co-operative credit institutions in relatively underdeveloped states. The state governments were also involved in extending financial assistance.[33]

CONCESSIONS IN ASSISTANCE BY BANKS UNDER SPECIAL SCHEMES

EXEMPTION OF ADVANCES TO BENEFICIARIES UNDER SPECIAL SCHEMES

With a view to enabling the IRDP beneficiaries to avail of the concessions provided under the IRDP scheme, the Reserve Bank advised SCBs in February 1984 that advances against commodities (covered under the selective credit control) sanctioned to the IRDP beneficiaries would be completely exempt from the purview of selective credit control. In May 1984, banks were advised about additional categories of advances, which were also to be completely exempt from the purview of selective credit control. These were: advances to beneficiaries under the scheme of providing self-

32. Reserve Bank of India, RPCD, BC Plan 113 A 22, May 4, 1989.
33. Reserve Bank of India, *Report on Currency and Finance, 1981–82*, p.199.

employment to educated unemployed youth in their endeavour to take up processing, manufacturing or trading activities in commodities covered by selective credit control; advances against such commodities to borrowers satisfying all the conditions under the DRI scheme; and small advances up to an aggregate limit of ₹ 5,000 per borrower, subject to the condition that the borrower dealt with only one bank.

With a view to exercising control over the sanction of credit limits by state co-operative banks and central co-operative banks in respect of sensitive commodities subject to selective credit control, NABARD[34] was advised to obtain prior approval of the Reserve Bank for proposals covering such commodities and involving amounts exceeding ₹ 5 crore.

LIBERALISATION IN TERMS AND CONDITIONS

The interest rate on short-term loans from SCBs (including the RRBs) to farmers for agricultural purposes for amounts above ₹ 15,000 and up to ₹ 25,000 was reduced effective March 1, 1989 from a range of 12.5 to 14.0 per cent to 12.0 per cent per annum. Simultaneously, the margin and security norms were also relaxed. Concession of margin money waiver was extended from up to ₹ 5,000 for certain loan categories to ₹ 10,000 for all agricultural loans. Banks were advised not to obtain collateral through mortgage of land/charge on land or third-party guarantee for crop loans and term loans of up to ₹ 10,000 each, where movable assets were created. In the case of genuine difficulties in creating a mortgage of land or charge on land, where it was required, banks could ask for a third-party guarantee or similar security as considered appropriate. Effective November 24, 1988, the interest rates on term loans for wasteland development were prescribed at 10.0 per cent in the case of individuals or group of individuals, such as co-operatives, and 12.5 per cent for corporate and other borrowers.

LOANS WRITE-OFFS

The banking system, which was reeling under pressure because of poor profitability, was also expected to bear the losses arising from agricultural loan write-offs used as a means to garner votes by the politicians. The Reserve Bank was not in favour of writing-off or rescheduling loans, but the state governments paid scant heed. They went ahead with write-offs,

34. NABARD had begun to administer CAS to these institutions from 1982.

creating an atmosphere of wilful default and making recovery efforts very difficult.[35]

In a meeting on June 22, 1987 with the Deputy Governors, Executive Directors, and in-charges of some departments, the Governor indicated his views on the Haryana Government's decision to move farmers' liabilities onto the banking system: "The Government taking over the liabilities would totally vitiate the climate for recovery of loans and seriously impair the capacity of financial institutions to recycle their loans and provide fresh financing. The decision, therefore, has a far-reaching effect on the whole system of rural credit."

The Reserve Bank's attention was drawn to media reports that state government of Haryana had decided to write-off loans by commercial banks and co-operatives aggregating ₹ 227 crore to several categories of borrowers. Of this ₹ 162 crore was stated to be due to commercial banks. The Reserve Bank indicated in this regard that no authority other than the commercial banks themselves could write-off loans that they had granted. It was also clarified that any deterioration in the environment of recovery of bank dues and the consequent defaults would seriously affect fresh lending by banks to the detriment of the rural community and credit system.

In the context of the prevalent situation concerning bad loans and recovery position of the banks, a media report noted, "Terms like recovery rate and bad debt write-off which related to the management of bank credit and which not long ago used to figure mostly in deliberations within the four walls of boardrooms and in highly professional forums had become matters of public debate and controversy."[36]

While the loan *melas* pushed by the Minister of State for Finance invited sharp criticism from many including the bank staff, on the grounds of heavy leakage, corruption, and partisanship, the political leaders tended to adopt a public posture which generated a feeling among borrowers that they did not need to worry about discharging their debt. Promises of loan write-offs were offered generously, especially on the eve of elections. The ministers in the Government did not hesitate to instruct the officials of the bank to oblige certain favoured loan applicants, who had strong political backing. An organisation of bank employees went to the extent

35. Write-off of Farm Loans: Notes from the Reserve Bank of India Board Memorandum File F 4159 30-11-87 to 11-12-87.

36. "A Mounting Problem", Editorial, *The Hindu*, August 17, 1987.

of suspecting a nexus among politicians, industrialists and top bank executives and demanded that a parliamentary committee be set up to look into the write-off cases.

STUDIES AND WORKING GROUPS RELATING TO RURAL DEVELOPMENT

As part of the World Bank-aided NABARD-1 credit project, an extensive review of the agricultural credit system in India was undertaken. The review consisted of five studies, *viz.*: (i) role and operations of the agricultural credit system; (ii) role and effectiveness of individual lending institutions; (iii) scope of supervisory and regulatory functions of the apex-level institutions in agricultural credit; (iv) cost of lending and profit margins; and (v) efficacy of operations of NABARD. These studies were envisaged to be conducted under the guidance and supervision of a senior-level expert group, which was expected to evaluate major problems and issues affecting the agricultural credit system and make recommendations for a programme to strengthen the sector.

The working group appointed in June 1984 to study the operational problems of the state handloom development corporations in relation to bank credit completed its field studies in Karnataka, Tamil Nadu, West Bengal, Uttar Pradesh and the north-eastern region. The field visits helped the working group to understand operational problems, such as supply and distribution of yarn to weavers, marketing of handloom products, and raising finance for production and marketing under local conditions.

The Reserve Bank set up a high level standing committee in November 1985, under the chairmanship of Dr P.D. Ojha, Deputy Governor, to review the flow of institutional credit to the rural sector and other related matters. The committee was required to suggest measures to improve the credit delivery system for greater benefit of weaker sections. The terms of reference of the committee were: (i) to review and assess the requirements and availability of institutional credit for agricultural and rural development; (ii) to identify operational shortcomings, which inhibited effective delivery of institutional credit to intended beneficiaries and suggest remedial measures; (iii) to examine the progress made in correcting regional imbalances in the matter of agricultural credit and related facilities, and to recommend appropriate steps for improvement; (iv) to suggest measures for co-operatives and LDBs at state and district levels to become effective agencies to facilitate flow of rural credit; (v) to review the progress of flow of credit and complementary inputs to weaker sections of society and recommend measures for improvement; (vi) to recommend measures for improving the effectiveness of co-ordination between credit institutions and various state government agencies at or below the district level; (vii) to suggest improvements in needed infrastructure support and packages of complementary inputs including technological back-up to make rural credit more effective; (viii) to identify factors which adversely affected the timely recovery of rural credit and suggest ways and means to improve recycling of funds of credit institutions; and (ix) to promote co-ordination at the national and state levels among credit institutions and other agencies associated with institutional credit for agricultural and rural development.

The committee constituted a working group: (i) to consider problems relating to non-availability of credit to new and non-defaulting members of co-operative credit institutions and to suggest measures to ensure smooth flow of credit to such borrowers; and (ii) to recommend measures for assisting the co-operative credit structure in areas susceptible to repeated natural calamities and assess their impact on recovery of loans.

The committee had periodic meetings and reviewed the issue of flow of credit to rural and other related sectors. The reviews, *inter alia,* included extending agriculture credit card facilities, crop insurance scheme, strengthening of co-operatives, performance of banks in lending for the activities included under priority sector, steps taken by the Government with regard to creating infrastructure facilities in rural areas, and implementation of the SAA for rural lending by banks. In one of the meetings, the chairman of the committee observed that the banks did not own the funds that they lent; instead these were deposits mobilised from the public, who trusted banks with their money not only with the objective of earning interest but also because they had faith in the banking system. Hence the committee felt that the goal was to strengthen this trust and earn the confidence of depositors by creating a healthy investment climate. The committee emphasised that there should be effective integration of development plans and the Planning Commission should initiate steps in that direction.

CONCLUDING OBSERVATIONS

In the early 1980s, the concern about inadequate flow of credit to agriculture and other priority sector activities continued despite several initiatives both from the Government and the Reserve Bank. A landmark was establishment of NABARD in 1982, converting the erstwhile ARDC and merging ACD of the Reserve Bank, to exclusively focus on agriculture and rural development. NABARD was entrusted with a pivotal role in the sphere of policy planning and providing refinance facilities to rural FIs to augment their resource base. The overall regulatory function was, however, retained by the Reserve Bank in view of its overarching statutory responsibilities over rural credit system. A separate department, namely the RPCD was set up in the Reserve Bank simultaneously to encourage and, at the same time, to exercise regulation and supervision over rural credit and priority sector activities of banks and other institutions. The Reserve Bank also set up several committees and working groups from time to time to closely monitor the flow of credit to rural sector and improve the performance of the institutions involved in rural credit.

The Government formulated a series of schemes and implemented a variety of programmes subsidising rural credit and financing rural development. The Reserve Bank, as a partner in the process, issued a series of instructions to banks in the form of circulars and guidelines and relaxed credit norms to support such government programmes including lending targets and sub-targets.

The emphasis on achieving specific quantitative targets with respect to rural credit, however, had certain adverse consequences. The supervisory focus tended to be biased towards target achievements rather than adhering to prudential requirements and ensuring viability. Adequate attention was not paid to qualitative aspects of lending. Poor loan recoveries and defaults in rural lending became a serious concern in the 1980s. This was partly due to natural causes such as volatile agricultural production in non-irrigated areas, and to an extent on account of other factors such as wilful defaults, especially among relatively better-off farmers; direct interventions by elected representatives often leading to full or partial across the board loan write-offs, thereby creating strong disincentives for loan recovery; and weak legal processes and support for recoveries. The co-operation from some state governments was also inadequate to improve the recovery climate. The result was a disturbing growth in overdues, which not only hampered recycling of scarce resources of banks but also adversely affected the profitability and viability of FIs.

Despite such shortcomings, the overall objective of broadening and deepening of the rural credit system was achieved over the Plan decades. The dependence of rural households for cash debt on non-institutional agencies declined substantially during the period 1971 to 1991. The share of formal lending more than doubled, reflecting the persistent efforts of the Government and the Reserve Bank. The strategies adopted in the 1980s in respect of rural credit resulted in substantial gains, and these primarily related to broadening of the rural infrastructure for credit delivery and improvements in credit outreach.