Ind. Jn. of Agri.Econ.
Vol.67, No.1, Jan.-March 2012

Subject III

Innovations in Agricultural Credit Market: Rationalisation of Policy Response

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The present summary of the proceedings is based on the insights drawn from the review of papers attempted in the rapporteur report published in Indian Journal of Agricultural Economics and the discussion in the technical session on the captioned theme. A total of 23 papers were submitted under the theme of which seven were presented during the technical session. While the concept innovations in the field of agricultural and rural credit was looked at focusing on the design and nature of products, processes and institutions, it was emphasised that the broader context of the past and present policy framework needs to be kept in mind in analysing those innovations. The nature of innovations depends on the context in which they emerge. Based on the review of the papers submitted and the relevance of exploring clearly the post-reform response of the rural financial institutions (RFIs) with regard to innovations in agricultural credit market, the following questions were raised for the purpose of discussion in the technical session and for further research under the theme.

(i) Identify the major policy reforms initiated in relation to RFIs? What is the true nature of these policies and their potential that affect the working of rural financial markets? What are the areas in which reforms may be continued and the areas in which they may be reversed?

(ii) What are the measures initiated to overcome some of the negative consequences of reforms like exclusion of poor and small borrowers, increasing cost of borrowing and growing influence of informal sources? How far these measures have helped reverse these negative consequences?

(iii) What is the evolving institutional structure in rural areas to meet the emerging credit needs? What type of innovations has been attempted here? What are the merits and demerits of such institutional changes for ensuring

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The author is thankful to the valuable inputs from the proceedings provided by S.V. Ramana Rao, DOR, Hyderabad and R.R. Biradar, Karnataka University, Dharwad.

affordable and hassle free access to financial services by the rural households in general and small and marginal farmers in particular?

(iv) What are the innovative product and services developed by the RFIs to meet the diverse financial service needs of the farmers and other rural households? In what way these innovations have proved beneficial? How far some of the controversial innovations like commodity futures and derivatives have delivered for the farmers? What are the areas of rural credit delivery in which further improvements/innovations are needed so that credit can play a more effective role?

(v) What is the impact of these reforms and innovations on the farm economy? How far these measures have contributed for either aggravating or mitigating the agrarian crisis?

The papers submitted and presented were classified under four broad areas: 1) Policy level initiatives; 2) Working and impact of rural finance institutions 3) Innovations in products/services; 4) Microfinance. The summary of the discussion and major policy suggestions made under each of these areas are presented below:

1. *Policy Level Initiatives:* The papers under this theme looked at policies like distribution of credit and interest subvention scheme and brought out issues arising out the these policies on the inequality in the flow of institutional credit, and outcomes achieved through these polices for increasing the demand for credit. Certain negative aspects of the interest subvention scheme especially on the financial conditions of co-operatives were brought out. It was argued that interest subvention and the resultant credit flow may not result in increased farm productivity as such. As credit may not be able to play *per se* a significant role in increasing productivity, it would be useful to facilitate provision of non-credit inputs/services to enhance agricultural productivity. The need to focus also on the provision of infrastructure and other measures for enhancing credit absorption capacity was highlighted. A balanced credit flow through suitable policy interventions for sustainable agricultural growth was recommended. Credit needs to be channelised even to diversified activities like animal husbandry. In the discussion, the need to carefully measure the relationship between credit and agricultural productivity was highlighted in order to assess properly the impact of any such scheme.

However, given only a limited number of papers in this area, the working of many other policy initiatives, be it the new priority sector lending policy or the deregulation of interest rates or even the effort at doubling the agricultural credit, could not be discussed. Hence, no overall assessment of the impact of the emerging policies for innovations could be made.

2. *The Working and Impact of RFIs:* The post-reforms period has brought out about many changes in the structure of the RFIs. While the multi-agency approach continues, each of the major constituent units of the RFI network, viz., commercial banks, RRBs and co-operatives have undergone reform driven changes. The discussion here largely focused on the co-operatives. It was brought out that while the access to credit from co-operatives has shown the potential of creating a positive impact on agricultural production, the working of co-operatives continues to suffer from challenges like uneven spread, declining share of their lending, inadequate coverage of farmers, poor lending practices, and mounting overdues. The co-operatives especially during the reform period have adopted innovations like Business Development Plan, KCC and SHGs. There is a need to make an assessment of the impact of these innovations in reviving the co-operatives. Concerns were also expressed on the professional capacity of the co-operatives and their lack of business acumen and culture. Streamlining of the working of co-operatives was called for. Prompt sanction of loans, ensuring adequacy of credit, and linking of credit with marketing are some of the specific measures suggested for improving the working of co-operatives. Suggestions were also made for a clear cut plan for financial inclusion of all the needy by the PACS. The need to positively use the revival package for strengthening co-operatives was emphasised. At the same time, the relevance of providing various kinds of policy support including meeting their credit needs to newer types of co-operatives like the self-reliant co-operative and producer companies was brought out.

About the working of rural banks like RRBs, insufficient number of branches and higher cost of borrowing were the concerns identified in enhancing the role of institutional credit especially for small and marginal farmers. As augmenting capital needs of marginal and small farms can increase farm productivity and viability, expansion of rural bank branches with sufficient staff and adoption of simplified documentation in loaning were suggested. Reduction in the cost of borrowing through lower pricing and reduction of transaction cost in loan delivery were also identified in this regard.

3. *Innovation in Products and Services*: The RFIs have tried to introduce several innovations in products and services offered by them during the post- reform era. Some of these innovations include the Kisan Credit Cards (KCCs) meant to help farmers access financial services at lower cost and without many of the hassles, National Agriculture Insurance Scheme (NAIS), weather based insurance and warehouse receipt financing to specially equip farmers to cope with risk and uncertainties associated with agriculture.

The papers on KCC highlighted that there has been an impressive growth in the issue of KCCs. Several positive aspects of the impact of KCC on cost of borrowing and agricultural productivity were noted. However, many limitations and shortcomings coming in the way of KCCs emerging as a really innovative and a flexible instrument capable of streamlining credit flow to farmers were identified. There are wide variations across regions and land-size categories in the coverage of KCCs. A large number of small and marginal farmers, tenants and share croppers are yet to be covered under KCC. Rigid norms and procedural hassles have made KCC a highly restrictive facility and a considerable proportion is found using it more as one time loan than as a flexible cash credit facility. As a result of all these constraints, KCC has not been able to reduce significantly the credit gap and the dependence on other sources of credit.

A more proactive approach on a mission mode using ICT and simplified procedures are identified as possible measures to increase the coverage and effectiveness of KCC. The need to improve the coverage of small and marginal farmers under KCC was emphasised to bring in equity. Suggestions for introduction of biometric and smart cards, elimination of middlemen, and organising village campaigns for increased adoption of KCCs were specifically made. Recommendations were made for evolving KCC as a truly multipurpose instrument combining the needs of term loan and consumption loan in a suitable measure.

No discussion could take place on various products meant for mitigation of risk like crop insurance. But the papers submitted brought out the fact that despite several innovations there is still a long way to go before an effective risk mitigation measure for farmers can be put in place for a wider adoption. The new crop insurance scheme though has a potential for creating positive incentives for efficient resource use, is found to be poor in its coverage due to procedural and other constraints. The warehouse receipt financing needs to be more innovative to be beneficial for the farmers. Increasing farmers' awareness, simplification of the scheme, adoption of a decentralised approach are identified as possible measures to make the agricultural insurance more effective with an increase in its coverage.

4. *Microfinance:* Microfinance has emerged both as an innovative and an alternative mechanism of delivering financial services to the poor. In India the growth of microfinance has been rapid particularly during the post-reforms period during which the formal sector has shown a strong tendency of excluding the poor and other small borrowers. The microfinance method through the group approach tries to overcome the constraints and bias faced by the poor in accessing services from the formal agencies. There are broadly two models of microfinance in India, viz., the SBLP model and the MFI model.

The papers presented focused largely on the SBLP model. The findings brought out the innovative aspects of the group approach in enabling the poor to have regular access to small savings and credit by reducing the cost of transaction. The group linkage has spread rapidly to bring in large number of poor especially women under the fold of formal agencies. The access created has made a significant impact on the income and employment conditions of the members. The papers also highlighted various limitations faced by the SHGs both in improving the access and contributing to change the members' economic conditions. The SBLP has shown a much skewed spread geographically and a large section of the poor still remain excluded. SHGs besides their limited focus on agriculture have shown limitations in covering wide variety of rural producers who otherwise find it difficult to participate in SHGs.

The papers in this section could not bring out explicitly some of the key issues of concern in the SHG linkage process and the limitations faced by microfinance to emerge as an alternative mechanism of financial inclusion. The continued exclusion of poor even from microfinance models was highlighted during the discussion.

About the findings on the positive impact of microfinance, the need to carefully identify and address the challenge of attribution was emphasised. A suggestion was made to conduct an orientation workshop on proper impact methodology for young researchers. In terms of policy measures, expansion of SHG linkage model to cover the excluded households and adoption of varied group models including joint liability groups was brought out. The role of suitable NGOs/SHPIs and better coordination among various agencies involved were highlighted. At the same time, besides credit the relevance of addressing various other problems of poor for their socio-economic development was emphasised.

CONCLUSION

Overall, the session brought out the relevance of innovations in solving the fundamental problems of rural credit pertaining to equity, accessibility, affordability and adequacy. Many of the specific innovations examined though have shown potential for positive outcomes but continue to suffer from various constraints coming in the way of their success and scaling up. These constraints pertain to both systemic and design level issues. At the systemic level, the need is to create a more proactive and conducive policy and support framework for innovations to thrive for farmers and the poor. At the design level, the need is to be more participatory and decentralised to come out with relevant institutions, products and services. Resolving the basic problems of agricultural credit through innovations can play a potentially useful role in addressing the fundamental challenge of rejuvenating agriculture and rural livelihood.