

Poverty Alleviation or Financial Inclusion?

1. Indian Growth Experience - Role of Finance:

All through our developmental efforts, a lead role has been assigned to finance. In the specific context of rural development, financial assistance was supposed to lead to rural poverty reduction, increase in farm output, expansion of off-farm employment, reduction in inter-regional disparity, etc. Hence, many financial institutions have been established from time to time to catalyse the development process. Some of them were established to cater to specific needs of special clientele groups. The operational parameters of financial institutions have vastly changed due to the financial reforms since 1992. Social banking concerns have given way to viability concerns with banks and other financial institutions now being subjected to stringent prudential norms, reduction of NPA's and earn profits.

2. Directed Credit

Since 1967, with social control over banks and then nationalisation of major banks in 2 phases (14 in 1969 and 6 in 1981), there has been directed lending of credit (40% of net bank credit for priority sector with a sub-sector target of 18% for agriculture), interest rate controls on credit (upto Rs.2 lakhs), Differential Rate of Interest Scheme (interest subsidy) and various capital subsidy schemes like IRDP, SGSY, etc. If we review the sum total of what the priority sector and directed credit flow by RBI, has achieved, then the agrarian crisis, the poor state of rural infrastructure and 280 million people under BPL, are surely matters of concern. The unending number of suicides by farmers is a result of years of

systematic neglect of the agricultural sector despite thousands of crores of rupees in subsidies for free power, fertilisers, etc.

3. Rural Services Sector :

Clearly, directed credit has assisted in the creation of a vast middle class in urban/semi-urban areas and funds continue to be diverted from rural areas to urban areas, as the rural C.D. Ratio data reveals. It is time we reversed this trend and scrapped the existing norms for directed credit. There is need to acknowledge that the rural services sector which is growing very fast, needs to be financed. It is not only the rural transportation sector and the rural small business sector, which is growing, but there is a need for enhanced credit flow to the following sectors:

- (1) Rural drinking water systems
- (2) Cheap rural housing
- (3) Rural sanitation
- (4) Eco-tourism sector
- (5) Renewable rural energy (ethanol, biogas, bio-diesel, etc.)

4. A Litany of Woes:

The credit-led development process, however, left a litany of woes too. In spite of the best efforts, India is still low on the development scale in the world. Whether it is child labour, primary school dropout levels, poverty levels, poor targeting of PDS or farmers distress, the country's performance is not remarkable, a few silver linings notwithstanding. The latter includes emergence of a vibrant middleclass in urban areas, growth of micro finance and Panchayati Raj Institutions to help the rural poor.

5. Financial Inclusion vs. Poverty Alleviation:

Poverty alleviation has all along been a priority goal of the Indian polity. Credit has been used as an important instrument in alleviating poverty. But as of now only 13% of rural households could avail of loans from financial institutions. Juxtaposing this fact with the extent of BPL population (280 million), the task ahead becomes very clear. Thus, financial inclusion can be seen as an intensification and continuation of poverty alleviation efforts. The present focus on financial inclusion through establishment of Financial Inclusion Fund (Corpus - Rs. 500 crore) and Financial Inclusion Technology Fund (Corpus - Rs. 500 crore) are steps in the right direction.

6. Extent of Financial Inclusion:

Financial Inclusion is the broad based delivery of banking and other financial services at affordable cost to the poorest sections of society. Financial services needed are safe deposits, affordable credit, micro insurance, financial literacy/counselling and quick and safe funds transfer.

The recent NSSO survey 2003 indicated that in 18 States, financial inclusion was only 49 per cent. All the Northeast and Eastern States were in the category of least "inclusion". In the remaining States where inclusion was more than 50 per cent, Andhra Pradesh was the lone major State with over 75 per cent inclusion. Scheduled Tribes with a proportion of inclusion of about 36 per cent are the least benefited social group. An additional dimension to the problem of inclusion is the resurgence of private moneylenders as the prominent source of credit to rural households since 2001. With growing disinterest of commercial banks in rural lending and increasing number of defunct primary agricultural cooperatives coupled with huge additional loan amounts (estimated at Rs.456 thousand crore) required for achieving financial inclusion of all rural households, the task ahead is a formidable one.

7. Initiatives for Financial Inclusion:

- i. **Increased outreach:** Banks may engage business facilitators/ correspondents to improve outreach to under-banked/tribal areas and under-populated areas in eastern/north-eastern regions. Further, they may establish rural counselling centres to advise people on financial products and assist them in managing payments.
- ii. **Information Campaign:** Various modes of information dissemination including the state of the art electronic media, and different forums like SLBC/DLRC / BLBC etc. may be used for spreading information on financial inclusion.
- iii. **Mobile Banking Vans:** Mobile Vans equipped with PC-net-connectivity, may be an effective way of reaching under-developed/under-banked areas.
- iv. **Supporting Village Level Initiatives:** Financial Inclusion Fund may be used for supporting all village level initiatives by different agencies.
- v. **Setting up Rural Credit Bureau:** Rural credit bureaus may be set up at district level by lead bank offices and credit rating of all rural customers may be targetted.
- vi. **Development of Client Based Products and Services:** Research based designing of financial products, establishment of training centres, setting up farmers clubs/associations are important.

- vii. **Technological Innovations:** Financial support to technological solutions aimed at providing affordable financial services to people need to be provided. In addition support for increasing technology adoption, better asset management, enhanced entrepreneurial capacity and increasing financial education literacy also have to be considered.

- viii. **Corporates as partners in Financial Inclusion:** While several corporate have entered in the fields of agriculture, many more need to be involved.

- ix. **Micro/Group Insurance Product:** There is a need to aggressively market micro insurance products, group insurance products of crop insurance products and risk management services.

Credit alone is not adequate for rural and inclusive development. There is need for the 'Credit Plus' approach. With the initiatives outlined above and by defining measurable targets to rural bank branches, we may positively bring about financial inclusion to the desired extent. In our journey towards that goal, we may adopt a few strategies like redefining the priority sector, involving rural moneylenders as per the Japanese Sarakin Model, focusing on the emerging rural service sector, planning insurance/pension products for the unorganized sector, etc.

8. Rural Priority Sector

There is a felt need to redefine our priority sector and agricultural sector (both direct and indirect) as the rural priority sector and ensure that this sector gets 25% of bank credit, from all banks (including foreign banks, as in Thailand) with the following sub-sectoral targets;

- i. 10% of bank credit for SHGs/JLGs/MFI's
- ii. 10% of bank credit for investment credit loans for agriculture
- iii. 4% of bank credit for handlooms/handicrafts/village and cottage industries/micro-enterprises
- iv. 1% of bank credit for DRI scheme (4% interest) for weaker sections of society.

This will ensure that the rural economy benefits from the directed credit and will ensure growth with equity.

9. Role for Money Lenders/Traders

The Japanese (Sarakin) model of incentivising registered money lenders to be business facilitators/bank's correspondents in rural areas could be given a fair trial with adequate safeguards. Moneylenders may be encouraged to finance SHG/JLGs, set up Rural Credit Bureaux on a district-wise basis under the Lead Bank Scheme, issue KCC/SCC/GCC on behalf of banks and also take up fee-based loan collection (sticky accounts) on behalf of banks. This will enable rural moneylenders to play a positive role in rural financial inclusion, provided they operate within the framework permitted by RBI regulations. They may also stand in as guarantor for bank loans as a fee-based activity. A limit of Rs.10 lakhs, at regulated rates, could be considered per moneylender.

Conclusion :

The SHG- Bank Linkage Programme has over 27 lakh SHGs credit linked (90% being women groups) and an estimated 410 lakh poor households have accessed the formal banking system. 666 lakh farmers have Kisan Credit Cards while rural self-employed persons have 7 lakh Swarojgar Credit Cards. More innovative credit products are needed if farmers are to benefit and credit,

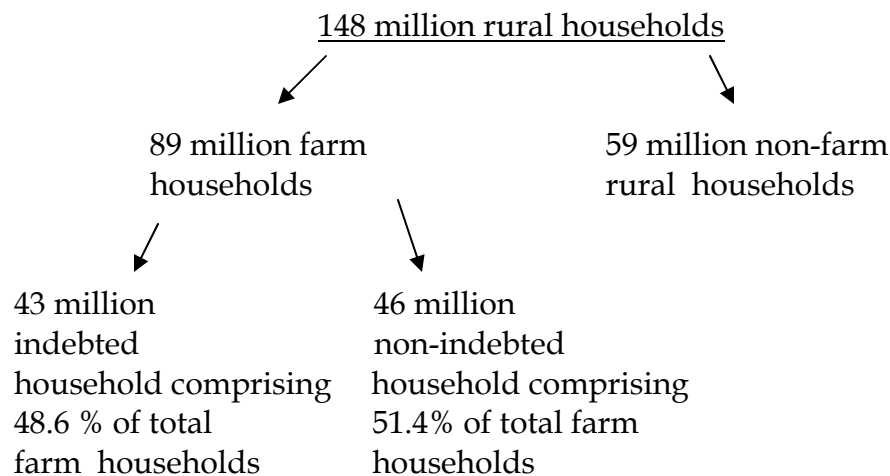
technology, input supplies extensive services, market information, consumption needs, counseling services all need to be factored in, along with creation of rural infrastructure for encouraging supply chain management systems. More agro-processing at farmer levels is needed for better income margins. The entire credit needs of farm households have to be considered when designing credit products. Initiatives such as the 'Homestead' model in Kerala, 'Wadi' in Gujarat and the SHGs as members of co-operatives in Uttarakhand, need to be factored in. A long-term vision for development of the agriculturists and of agriculture is needed, along with the twin objectives of equity with growth and environmental sustainability.

Dr.K.G.Karmakar
Managing Director, NABARD
16 July 2008

Agricultural Credit – An assessment

1) Introduction :

The Rural Credit delivery system is facing serious challenges with the rising cost of credit, tight liquidity, poor loan recovery due to write off of agricultural overdues and slowing of credit off -take. The rural credit delivery system has been concentrating on poverty alleviation or financial inclusion since 1793 (Annexure) and various institutions have been set up, at times without dwelling deep into causes for failures of earlier institutions. However, the levels of financial exclusion are high in both urban and rural areas, for the poor:



The All India Debt and Institutional Survey Report 2002 states that 13.4% of rural households are indebted to institutional sources, while another 15.5% are indebted to non-institutional sources. The need today is to ensure financial inclusion to all eligible for a bank account and provide financial services as required in rural areas.

2. Achievements?

The UN has assessed India at 128 out of 180 countries on the Human Development Index while the IFPRI have put our rank in the Hunger Index at 94, while China is at 47 and Pakistan at 88. 27% of all primary school dropouts all over the world are from India, while Child Labour is the norm rather than the exception. 157 districts are Naxalite affected while 25% of population (280 million) are assessed as Below Poverty Line (BPL). The NREGS is yet to succeed and land, water, forest resources are at critical levels of exhaustion. There is unending migration to the urban areas and 30% of the population is now urbanized. Rural poverty, under-employment, starvation and lack of safe drinking water and sanitation, poor education and medical facilities, all take their toll of the rural population. On all parameters, rural India has not been a success story except where communities/clusters of people have decided to make far-reaching changes, themselves. With 60% of the rural population dependent on agriculture for a living, we need to analyse what has gone astray in the agriculture sector.

3. Persistent Sinking of Farm Size

In 1960-61, 60% of cultivated area was operated by farms exceeding 4 hectares, but by 2002-03 the figure has reduced to 35%. The following tables reveal the shrinking farm sizes:

Percentage of Operational Holdings **NSSO - 2003**

| Holding category | 1960-61 | 1970-71 | 1980-82 | 1991-92 | 2002-03 |
|--------------------------|---------|---------|---------|---------|---------|
| Marginal (< 1 hec.) | 39.1 | 45.8 | 56.0 | 62.8 | 69.0 |
| Small (1 to 2 hec.) | 22.6 | 22.4 | 19.3 | 17.8 | 16.1 |
| Semi medium (2 to 4 hec) | 19.8 | 17.7 | 14.2 | 12.0 | 9.0 |
| Medium (4 -10 hec.) | 14.0 | 11.1 | 8.6 | 6.1 | 4.3 |
| Large (> 10 hecs) | 4.5 | 3.1 | 1.9 | 1.3 | 0.8 |
| | 100 | 100 | 100 | 100 | 100 |

PERCENTAGE OF OPERATED AREA**NSSO-2003**

| Holding category | 1960-61 | 1970-71 | 1981-82 | 1991-92 | 2002-03 |
|-------------------------|---------|---------|---------|---------|---------|
| Marginal (< one hec) | 6.9 | 9.2 | 11.5 | 15.6 | 22.2 |
| Small (1 to 2 hec.) | 12.3 | 14.8 | 16.6 | 18.7 | 20.6 |
| Semi Medium (2to 4 hec) | 20.7 | 22.6 | 23.6 | 24.1 | 22.4 |
| Medium(4 - 10 hec.) | 31.2 | 30.5 | 30.1 | 26.4 | 22.7 |
| Large (> 10 hec.s) | 29.0 | 23.0 | 18.2 | 15.2 | 12.1 |
| | 100 | 100 | 100 | 100 | 100 |

Sen and Bhatia (2004) have computed for each State, the minimum land holding size required to maintain a family of 5 above BPL. 50% of Indian States have average holdings less than the minimum defined. States with agricultural growth higher than average such as Assam, Haryana, Madhya Pradesh, Punjab, Tamil Nadu, UP and West Bengal, have farm holdings on average greater than the minimum required. Smaller sizes and less technology availability lead to lower credit leverage. Prices do not help in stemming agricultural decline, as structural factors turn adverse irreversibly. Also, loss of soil nutrients and declining water availability, are also important factors for poor farm production/productivity. Some other problems are: -

- i) Pattern of subsidies of fertilizer production (DAP) has skewed fertilizer use for urea thus impacting nutrient balance in soil. US \$ 16 billion in food subsidies in India has led to wasteful use of water resources, degradation of land and imbalances in fertilizer usage.
- ii) Free or unlimited subsidies for electricity has led to massive depletion of ground water.

iii) Need for encouraging an active lease market which current legislation does not permit, as tenancy is not officially recognized.

4. Gross capital formation in Agriculture :

Agriculture has suffered in the 1990's years due to neglect and apathy, as will be seen from the following table:

(Rs. In cr. at 1999-2000 prices)

| Year | Public sector | Private sector | Total |
|----------|---------------|----------------|-------|
| 1980-81 | 12521 | 14929 | 27450 |
| 1985-86 | 10509 | 12346 | 22855 |
| 1990 -91 | 7882 | 27691 | 35573 |
| 1995-96 | 8731 | 15854 | 24585 |
| 2000-01 | 7155 | 31580 | 38735 |
| 2005-06 | 13277 | 41628 | 54905 |
| 2006-07 | 15130 | 45632 | 60762 |

Due to small size of land ceilings and other problems in rural areas, capital investment for agriculture is poor in the public sector, reflecting the apathy for development initiatives in agriculture.

5. Irrigation needs

An ADB study shows that water available for agriculture has declined sharply over several decades in Asia and water scarcity would be increasingly challenging for China and India where irrigation water consumption as a share of total consumption, is projected to decrease by 5 to 10% between 2000 and 2050. Also, agricultural land is being increasingly diverted to urban / industrial uses as also scarce fresh water resources. With only 40% of land under irrigation, India ranks lower than Bangladesh, Nepal, China, Japan and Korea. Lower yields in agriculture in relation to East Asian countries is not inspiring and

agricultural yield stagnation, despite larger holding sizes than China, is a reality to be faced.

% irrigated area

Expansion of irrigation

| Crop/year | 1970-71 | 1980-81 | 1990-91 | 2000-01 |
|------------------|----------------|----------------|----------------|----------------|
| Cereals | 27.6 | 34.1 | 41.0 | 49.6 |
| Pulses | 8.8 | 9.0 | 10.5 | 12.3 |
| Food grains | 24.1 | 29.7 | 35.1 | 43.1 |
| Oilseeds | 7.4 | 14.5 | 22.9 | 22.5 |
| Cotton | 17.3 | 27.3 | 32.9 | 32.6 |
| Sugarcane | 72.4 | 81.3 | 86.9 | 91.3 |

Expenditure for irrigation has not declined since 1990-92 (8th Plan) The three deficiencies are at the level of planning, implementation and management. Irrigation sector thus suffers from poor governance.

6. Poor Research and Extension Services

Expansion of cultivable land is possible by irrigation, leading to double cropping and also by productivity increases due to better quality seeds, micro nutrients, organic pesticides, reduction of post harvest losses etc. Two decades of stagnant public capital formation, greater international competition and declining farm sizes and environmental degradation, have hampered yield levels. Research and extension services have not found their way to the farmers' fields as will be apparent from the following tables:

Growth in Rural Public Expenditure in Research and Extension

(%)

| Year | Research and Education | Extension and Training |
|-----------|------------------------|------------------------|
| 1960's | 6.5 | 10.7 |
| 1970's | 9.5 | -0.1 |
| 1980's | 6.3 | 7.0 |
| 1990-2005 | 4.8 | 2.0 |

Public Expenditure on Research and Extension as share of Agriculture GDP

(%)

| Year | Research and Education | Extension and Training |
|---------|------------------------|------------------------|
| 1960-62 | 0.21 | 0.09 |
| 1970-72 | 0.23 | 0.14 |
| 1980-82 | 0.39 | 0.11 |
| 1992-94 | 0.40 | 0.15 |
| 2001-03 | 0.52 | 0.13 |

Clearly, there is insufficient investment in knowledge for agriculture and consequently production and productivity, have suffered. Public expenditure and research extension as share of revenue spending, has lowered between 0.44% to 0.54% between 1987 and 2006.

7. Agri-Credit Woes

Efforts to increase the flow of credit have yielded better results between 1995-96 and 2006-07. However, the upswing in credit from non-institutional sources, including moneylenders is a source of concern, as seen in the following tables:

Share of borrowing of cultivator households

(%)

| Sources of credit | 1951 | 1961 | 1971 | 1981 | 1991 | 2002 |
|---------------------------------------|------|------|------|------|------|------|
| Non-institutional | 92.7 | 81.3 | 68.3 | 36.8 | 30.6 | 38.9 |
| Of which money lenders | 69.7 | 49.2 | 36.1 | 16.1 | 17.5 | 26.8 |
| Institutional | 7.3 | 18.7 | 31.7 | 63.2 | 66.3 | 61.1 |
| Of which co-operative societies/banks | 3.3 | 2.6 | 22.0 | 29.8 | 30.0 | 30.2 |
| Commercial Banks | 0.9 | 0.6 | 2.4 | 28.8 | 35.2 | 26.3 |
| Others | - | - | - | - | 3.1 | - |

Source : RBI/NSSO

However, the share of co-operatives in agricultural credit has been declining drastically.

Share of agricultural credit

| Institution/years | 1992-93 | 2006-07 |
|----------------------|---------|---------|
| Commercial Banks | 33% | 68% |
| Co-operatives /banks | 62% | 22% |
| RRBs | 5% | 10% |

The farmer -friendly co-operatives have not been able to expand credit operations and have developed weaknesses, which have hampered their growth. The Vaidyanathan Committee recommendation for strengthening rural co-operative credit institutions has been overtaken by the Debt Waiver Scheme 2008. The effect of such schemes of loan recovery efforts of banks remains to be assessed over the coming years.