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WP: 282

Working Paper

RURAL BANKING IN INDIA --
ITS PERFORMANCE AND PROBLEMS

By

B.M. Desai

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W P No. 282
July 1979

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of the IIMA is to help faculty members
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— ITS PERFORMANCE AND PROBLEMS —

B.M. Desai*

I

Introduction

This paper discusses in aggregate terms the performance of the formal rural financial market (RFM) in India. Considering three different aspect of this market several criteria are applied for this purpose. These three aspects are: (1) Sectoral allocation of credit, sectoral mobilization of deposits and sector's contribution to national income, (2) rural loan-term structure, extent of financial independence, default rate and the distribution of rural credit and (3) purchasing power of rural credit and the distribution of benefits arising from the concessional lending rates among different sized farms.[1]

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*This is a revised version of the paper presented to the Workshop on "Providing Financial Services to the Rural Poor" organized jointly by the Ohio State University, Ohio, U.S.A., and the Bangladesh Bank, Bangladesh at Dacca in October 1978. The author is grateful to Professor Dale W. Adams and Dr. MRichard Meyer of the Ohio State University, Dr. Robert C. Vogel of the Syracuse University, U.S.A., Mr. Majid Molla, Bangladesh Bank, Bangladesh, Mr. L. D'mello of the State Bank of India, India, and Professor C.H. Shah, of the University of Bombay, India for their valuable comments on the earlier draft. He is also thankful to Mr. M.S. Patel and Mr. Y. Narayana Rao for their assistance in compilation of data for this paper. He is alone, however, responsible for the paper.

[1] For application of some of the criteria related to these three aspects to RFMs in selected South-East Asian and Latin American countries, See Adams (1971, 1977a, 1978), Vogel (1977), Paulo F.C. dê Araujo and Richard L. Meyer (1977), and Wells (1978). Also see Shetty (1976, 1978) and Lipton (1976) for some relevant discussion on commercial banks' credit for various sectors in the Indian economy.

Considering the criteria related to the first aspect the recent performance of the RFM is impressive. However, growth in the factors associated with these criteria seems to have now stagnated. There also appears insignificant relationship of these factors with the real rate of interest. But, judged from the viewpoints of the criteria related to the second and the third aspect, the performance leaves much to be desired.

We attempt to further show in this paper that the basic problem of providing financial services to the rural sector lies in inappropriate methods of credit disbursement and those of savings mobilization. We contend that this has resulted from (a) inadequate appreciation of the nature of rural demand for financial services, (b) excessive emphasis on the supply-oriented concessional lending policies, and (c) a relative neglect of the dual character of the rural financial market in which formal and informal segments co-exist. There is a lack of varieties in the financial and debt instruments that are presently used. And the existing instruments do not match well with the nature of financial services needs of the rural households.

In what follows we discuss these. We first describe distinguishing features of the RFM in India. We then discuss the performance of the formal segment of the RFM in aggregate terms by utilizing data for 1961-62, 1967-68-69, and 1971-72 through 1976-77. A customary concluding section is finally presented.

II

Features of RFM

Rural Financial market in India consists of both the formal and informal agencies. The informal segment of this market is also termed as unorganized in the sense that it operates outside the provisions of the Indian Banking Companies Act. However, organization of this segment is much more complex and subtle. Neither the Reserve Bank of India (RBI) nor the Government of India (GOI) has a direct control over this segment. Both the enactment and the implementation of the legislation prohibiting and regulating money lending activities of the informal agencies are within the purview of the concerned state governments.

Two, even among the formal agencies there exists institutions that can be categorized into banking and non-banking institutions. While all commercial banks (CBs) and the cooperatives in the three-tier structure for rural credit are banking institutions, the cooperative land development banks (LDBs) can not be strictly called banking institutions. The land development banks do not have to maintain cash reserve ratio and liquidity ratio. Nor are they required to mobilize deposits.[2]

Three, cooperatives and commercial banks are subjected to differential treatment for banking regulations. The main implication of this treatment is that the cooperatives have greater ability to create credit and also to

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[2] Incidentally, LDBs share in outstanding rural credit given directly to farmers was 16 per cent in 1961-62, 38 per cent in 1968-69 and 43 per cent in 1975-76.

borrow more from the RBI than the commercial banks. This arises from two factors. Cooperatives unlike the commercial banks can borrow at an interes rate two per cent below the Bank Rate. Moreover, the cooperative (both Sta and district central cooperative) banks are at present required to maintai a cash reserve ratio of 3 per cent and a liquidity ratio of 25 per cent (RBI, 1970). Against this, the commercial banks are required to maintain 5 per cent of cash reserve ratio and 34 per cent of liquidity ratio. Not only are these ratios lower for the cooperatives, but in their computation for the cooperatives the borrowings from the RBI are excluded from the demar and time liabilities.

Four, while these concessional policies have been historically followed to promote cooperatives, with the nationalization of the major commercial banks incentives to undertake agricultural lending operations have been provided to these banks also. These include, among others, exclusion of borrowings from the Agricultural Refinance and Development Corporation (ARDC) in determining the demand and time liabilities, as well as in determining the ratio of term loans to deposits that the commercial banks are required to maintain. These banks can also get refinance at highly concessional interest rate under the Scheme of Differential Interest rate (DIR)[3]

[3] By June 1977, advances under such scheme as a percentage of total credit was less than one per cent (Shetty 1978). The interest rate under this scheme is 4 per cent.

Five, all the formal agencies appear to heavily depend on refinance and borrowing facilities from the government, the RBI and its sister organizations (ARDC, CREDIT GUARANTEE CORPORATION, etc.).[4] The instruments of intermediation between these agencies and the ultimate borrowers/savers include currency, equity, stereotyped savings certificates, mortgage of land, promissory notes, hypothecation of assets, and guarantees from the state governments. Against this, the instruments of intermediation in the informal segment of the RFM include currency, barter transactions, oral contracts for labour services for selling produce, for retaining surpluses from sale proceeds, for mortgage of tangible security and so on. Because of their informal character, the financial instruments of the informal agencies lack mobility and homogeneity (Ghatak 1976) However, the instruments of the formal agencies also appear to have similar features for the non-interest costs attached to them cannot be easily distinguished.[5]

Six, the formal agencies are largely uni-functional[6] in character (Jodha (Jodha 1974, 1977, Desai 1976, Doherty and Jodha 1977). Against this, the informal segment of the RFM is multi-functional in character (Choubey, 1977, Dantwala 1966, Desai 1976, Ghatak 1976, Hopper 1961, Lipton 1976b, ... 8 Matthai 1978 and Mellor 1966). Indeed the money-lenders very instruments

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4 Credit Guarantee Corporation provides risk-cover for lending operations of the cooperatives and commercial banks.

5 Non-interest costs which the borrowers have to incur vary from one agency to the other because of insufficient standardization in assessing collateral and other requirements for loan sanction decision. For insufficient standardization in terms and conditions for various types of rural loans of commercial banks, see reference number 35a.

6 In a very limited way these agencies perform multi-functional role by encouraging tie-up arrangements between borrowers, input dealers, and marketing organizations. However, such integrations are characterized by methods that lack in choice of terms and conditions for intermediation.

of intermediation are such that they enable them to operate not only in finance but also in land, labour, and commodity markets (Raj 1975, Desai 1976, Vyas 1977, Bardhan and Rudra 1978).[7] This is true of not only the conventional informal lenders but also the neo-informal lenders namely the agriculturists, - money lenders. Consequently the rural factor and product markets are interdependent rather than independent.

Seven, the uni-functional frature of the formal agencies endangers the viability of credit use, particularly because other rural markets are not yet well developed. The multi-functional structure of the informal agencies, however, ensures this viability. But such structure can hamper achieving social efficiency and equity objectives of development. This is because, under such structure the effective interest rate on credit is likely to have monopoly element. While this is one school of thought on this subject (Chandavarker 1965, 1971, Jain 1929, Wolf 1919), the other view is that the profit earned over and above the "normal" level by the informal lenders is more due to the high risks and administrative costs in agricultural finance (Ghatak 1976, Bottomley 1975, Long 1968, Mellor 1966). For the informal segment at an all-India level, it may not be unreasonable to assume that the latter view would hold. This, however, need not be interpreted to imply that there does not exist monopoly/ monopsony and oligopoly/oligopsony tendencies in some smaller regions.[8]

7 In mid-fifties money-lenders in only 12 percent of villages prpursued money-lending activity exclusively.

8 In 10 of the 15 States in 1961, one money-lender served 5,000 to 15,000 population. Also in 9 of these 15 states one money lender served 5 to 30 villages (Ghatak 1976).

Lastly, although cooperatives and the nationalized banks unlike the informal lenders are primarily concerned with the social instead of the narrow commercial objective, the formal agencies are not completely devoid of the concern for the financial viability of their own operations. This is borne out by the policy to reorganize the size of both the primary agricultural cooperative society (PACS) and district central cooperative banks (DCCB) (Apte 1973, RBI 1974, GOI 1976, Desai 1978c). The recommended norm of the credit business of Rs.2 lakhs for every PACS has also been prompted by this concern. Similarly, the latest attempt to establish Regional Rural Banks (RRBs) has been partly guided by the high costs of operations of the nationalized banks (GOI 1975). It is, however, not quite clear whether the nationalized banks and the RRBs like the cooperatives are supposed to pursue no-profit-no-loss objective in undertaking their rural finance operations. While the information to find out whether these banks have fulfilled such objective is not available, among the cooperatives nearly one-third of the PACS and one-tenth of the DCCB had incurred losses in 1974-75. These results have limited meaning inasmuch as they are based on costs that do not consider an allowance for default rate and inflation rate, leave aside the fact that they do not permit identification of "normal" profit.

To conclude, the existence of the two segments of the RFM that differ so drastically cannot possibly provide any organic link between them. Nor can the formal segment perform its "substitutive" role. Although the share of the formal segment in rural credit has increased from 7 percent in 1951-52, to 19 percent in 1961-62 and to about 32 percent in 1971-72, it is not known whether its share in rural deposits/savings mobilized by both the segments has increased or not.[9]

III

Performance of Formal Agencies

(1) Sectoral Allocation of Credit, Mobilization of Deposits and Contribution to National Income:

Over the years under study the amount of rural credit has increased more than the amount of institutional credit outstanding with all the sectors; for example rural credit in 1976-77 was about 15 times of what it was in 1961-62, whereas credit outstanding with all the sectors increased by 11 times during the same period (See Table 1). Such credit when divided into short-term and long-term purposes reveals that the former increased by about only 6 times, while the latter increased by about 40 times. Indirect rural credit which aids development of support institutions and input market channels increased by about 9 times.

Even the rural deposits during the same period increased more than the deposits mobilized from all sectors; while the rural deposits increased by about 4 to 5 times, the deposits from all sectors increased by about 3 times (Table 1).

The performance of the formal agencies in providing financial services to the rural sector appears satisfactory considering such other criteria as percent share of rural credit in credit outstanding with all the

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[9] For data on sources of credit, See RBI 1954, 1963 and 1977.

Table 1 Nominal Value of Formal* Credit And Deposits: Rural And Total, All-India

(Rs. in Millions Outstanding As on June 30)

Years	Rural Credit	Total Credit	Rural Direct Credit	Rural Indirect Credit	Rural Direct Term Credit	Rural Deposits (A)	Rural Deposits (B)	Total Deposits	Average Nominal Interest Rate On Rural Credit (%)	Average Nominal Interest Rate on Rural Deposits (%)
1	2[a]	3[b]	4	5	6	7[c]	8[c]	9[d]	10[e]	11[f]
1961-62	3,117[g]	16,124[g]	3,117	NA	500	NA	NA	17,186	6.0	3.8
1967-68	8,261[g]	39,195	8,261	NA	2,900	12,038	NA	46,950	9.5	5.5
1968-69	11,903[g]	43,940[g]	10,682	1,221	4,200	15,781	5,540	52,983	9.5	5.5
1971-72	23,959	75,911	20,883	3,076	NA	27,277	10.586	87,262	10.0	6.0
1972-73	26,218	87,040	21,782	4,436	13,191	35,340	14,038	106,160	10.5	6.0
1973-74	29,513	107,010	24,050	5,463	14,198	41,026	16,658	124,173	11.5	6.7
1974-75	35,251	121,868	27,237	8,014	15,738	47,765	19,594	145,062	13.0	7.5
1975-76	39,993	148,046	31,489	8,504	17,715	58,005	23,480	174,672	13.5	7.7
1976-77[h]	45,962	171,681	35,628	10,334	19,662	NA	NA	NA	13.5	7.0

NA = Not Available

*Formal Credit excludes credit extended by the government

Notes: a. Rural credit is defined to include direct and indirect credit to agriculture. Direct agricultural credit is extended in cash and kind directly to the farmers, whereas indirect agricultural credit is extended to the supporting institutions like primary credit societies, input dealers, electricity boards, agro-industries

(Contd....P.10.)

otes to Table 1 (Contd....)

orporation, and agro-service centres. Such credit is given to improve infrastructure and to facilitate easy availa ility of modern inputs to the farmers. In the case of cooperatives indirect rural credit excludes grain procureme inance and relates mainly to credit extended to apex, regional or primary level societies other than agricultural redit societies for distribution of inputs, purchase of agricultural implements, marketing of crops and processing gricultural produce. Direct term credit of cooperatives excludes credit to primary banks and societies by Central and Development Banks (CLDBs), but includes total loans disbursed by primary LDBs as well as those by CLDBs to ndividual farmers.

- Total formal credit outstanding is credit extended to agriculture and non-agriculture sectors.
- Rural deposits (A) in columns 7 and 9, include savings plus fixed deposits of rural and semi-urban branches of commercial banks and those of the DCCBs and the SCBs. Rural branches are those which are located in Centres wit population upto 10,000. Against this, semi-urban branches are those located in centres with population of 10,000 to 0.10 million. Rural deposits (B) in column 8 and 9 includes savings plus fixed deposits of rural branches of commercial banks and those of the DCCBs and the SCBs.
- All deposits include rural deposits (A) plus savings and fixed deposits of urban and metropolitan branches of the commercial banks.
- This is an average of nominal interest rate charged by cooperatives and commercial banks on their direct and indirect short-term and term-loans to agriculture.
- This is an average of nominal interest rate offered by cooperatives and commercial banks on the savings and fixed deposits.
- Excludes indirect rural credit of cooperatives, due to non-availability of data.
- Data for 1976-77 are estimated.

ata Sources:

- Report on Currency and Finance, Vol. I and II, Economic Review, Reserve Bank of India, Bombay, 1961-62, 1967-68, 1968-69 to 1976-77.

Statistical Statements Relating to Banking in India, Reserve Bank of India, Bombay, 1961-62, 1967-68, and 1968-69.

Basic Statistical Returns, Reserve Bank of India, Bombay 1972, 1973, 1974, and 1975.

Statistical Statements Relating to Cooperative Movement in India, Part I, Credit Societies, Reserve Bank of India, 1961-62, 1967-68, 1968-69, and 1971-72 to 1975-76.

Rangarajan C., "Banking Development Since Nationalization and Reduction in Disparities," Sankhya, The Indian Journal of Statistics, 1974, Vol. 36, Series C, Parts 2 & 4.

Reserve Bank of India, "Performance of Public Sector Banks in Agriculture", Reserve Bank of India Bulletin, April 1974.

sectors, and the share of rural deposits in deposits mobilized from all the sectors. For example, the share of rural credit in the total credit in the seventies had increased to around 28 to 30 percent from about 20 percent in the early sixties. Similarly the share of rural deposits in the total deposits was around 25 percent in the sixties, whereas in the seventies it had grown to around 33 percent (See Table 2). Both these performances appear satisfactory considering the agricultural sector's contribution to the national income during the years under study (See Table 2).

Notwithstanding the importance of these performances, it may be pointed out that since 1973-74 the shares of both rural credit and rural deposits have stagnated (See Table 2). Secondly, the rural credit to rural deposit ratio also reveals the same feature. Thirdly, to an extent, even the percentage of rural credit to net domestic product from agriculture has also shown similar sign.[10] These three features must be appreciated keeping in view the high dependence of rural households on informal or non-institutional sources of credit; while nearly 70 percent of their cash debts was obtained by all rural households from such sources, the corresponding percentages were about 88 for small farmers, and 95 each for rural artisans and agricultural labourers (RBI, 1977).

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10 Medium and large-scale industries had a share of over 60 percent in the institutional credit, even though they contributed only one-tenth to the NDP or less than 25 percent to the gross value of output of commodity producing sectors. For extensive discussion on this see Shetty (1978).

Table 2 Selected Measures of Performance of the Formal Agencies for Rural Credit

Years	% of Rural Credit to Total Credit	%of Rural Deposits to Total Deposits (A)	(B)	% of NDP from Agri. to Total NDP	% of Rural Credit to NDP from Agriculture	% of Rural Direct Credit to Rural Cre-Credit
1	2	3[a]	4[a]	5	6	7
1961-62	19.3	NA	NA	48.1	4.6	NA
1967-68	21.1	25.6	NA	50.6	5.8	NA
1968-69	27.1	29.8	10.5	48.5	8.5	NA
1971-72	31.6	31.3	12.1	45.7	14.3	87.2
1972-73	30.1	33.3	13.2	45.8	14.3	83.1
1973-74	27.8	33.0	13.4	49.6	12.0	81.5
1974-75	28.9	32.9	13.5	47.0	12.8	77.3
1975-76	27.0	33.2	13.4	43.1	15.3	78.7
1976-77[b]	26.8	NA	NA	NA	NA	77.5

NA = Not Available

a. Refers to earlier mentioned two definitions of rural deposits. For details see note c to Table 1.

b. Estimated

The preceding dissenting features are strengthened when criteria relating to the other two aspects of the performance of the formal agencies are also considered.[11]

(2) Rural Loan-term Structure, Extent of Financial Independence, Default Rate, and Distribution of Rural Credit:

The percent of rural term credit to total rural credit has stagnated around 57 per cent. Same is true of rural direct term credit to rural direct credit (See Table 3). Secondly, the formal agencies have been able to meet the credit needs of the rural sector from the deposits mobilized from this sector itself. This is, however, true only if rural deposits are defined to include deposits mobilized from both the rural and semi-urban branches of these agencies. Deposits mobilized by the rural branches alone were indeed inadequate to meet the rural credit needs (See column 5 in Table 3).[12] This is particularly true of the cooperatives which are known to have failed in deposit mobilization.

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[11] This finding remains unchanged, when formal credit is defined to include government loans, besides the bank loans. It also remains unchanged when gross value of output instead of net domestic product is considered. It is further insensitive to the definition of rural sector as 'priority' sector consisting of small scale industries, household industries including artisans, small businesses, etc, besides agriculture and allied activities (See Shetty 1976, 1978).

[12] This criterion is essential despite the fact that the rural sector may have smaller potential for providing deposits. What appears to be constraining the performance in this regard is the inappropriateness of the savings instruments rather than the existence of smaller amount of savings potential.

Table 3 Rural Loan-Term Structure, Rural Credit Deposit Ratio and Default Rate for Direct Rural Credit

Years	% of Rural Term Credit to Rural Credit	% of Rural Direct Term Credit to Rural Direct Credit	Rural Credit to Rural Deposit Ratio					Default Rate@ for Rural Direct Credit			
			All Agencies		Com.Bks.		Coop. Banks	All Agencies	PACS	LDB	CBS
			(A)[a]	(B)[a]	(A)	(B)					
1	2	3	4	5	6	7	8	9	10	11	12
1961-62	NA	NA	NA	NA	NA	NA	2.13	NA	NA	NA	NA
1967-68	NA	NA	0.69	NA	0.01	NA	2.24	NA	32.0*	1.7*	NA
1968-69	NA	NA	0.75	2.1	0.14	1.12	2.51	NA	34.6*	1.6*	NA
1971-72	NA	NA	0.88	2.3	0.21	0.96	3.26	NA	41.6	23.0	49.3
1972-73	59.5	60.6	0.74	1.9	0.19	0.81	2.64	NA	36.1	38.3	53.4
1973-74	58.9	59.0	0.72	1.8	0.20	0.77	2.58	40.2	40.1	30.2	49.3
1974-75	56.6	57.8	0.74	1.8	0.22	0.82	2.62	40.9	40.0	35.6	48.4
1975-76	57.2	56.3	0.69	1.7	0.23	0.82	2.54	40.3	38.6	33.8	48.1
1976-77	56.7	55.2	NA	NA	0.22	0.76	NA	NA	NA	NA	NA

NA = Not available

a Refers to earlier mentioned two definitions of rural deposits. For details see note c to Table 1.

@ Default rate is worked out by using default amount as a percentage of amount due for recovery.

* For want of data on amount due for recovery for these two years, default rate is computed with reference to outstanding loans..

Data Sources: Same as for Table 1 plus "Agricultural Financing by Commercial Banks: A Look Ahead," B.M. Ghiara, Prajnan, Vol. VI, No.3, July-Sept. 1977.

The results of the criterion of the default rate[13] of rural credit reveal that this rate h s perpetuated around 40 percent. Such poor performance is regardless of the type of formal institutions (See Table 3). What is disquieting about this performance is the inadequate improvement in this rate[14] over the years. Moreover, the default rate is found to be much higher for larger farmers and for very small ones than that for the small and medium farmers (Desai 1977, 1978). Such performance in regard to this criterion implies an erosion of capital structure of the financial agencies. This erosion is further compounded when inflation rate is also high. This brings us to examine the last aspect of the perrformance of these agencies.

Before discussing this aspect, let us briefly present the major findings about the skewness in the distribution of rural credit given directly to farmers.[15] One, long-term cooperative as well as commercial bank credit is more skewed than the short-term credit. Two, over time the skewness in long-term cooperative credit has declined, while that in the commercial banks' long-term credit has increased. This is to an extent also true of short-term credit of the commercial banks. And three, large

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[13] Since the available data do not permit the distinction between temporary delinquency and the eventual nonrepayment of loans, the default rate is computed as the ratio of overdues to the loans which are due for repayment on a given date.

[14] For discussion on causes of default, See Desai 1978b and 1978c.

[15] For a country like India, the skewness in the geographical distribution of rural credit and rural deposits is also a very important criterion for judging the performance of the formal agencies. For detailed discussion on this see Ghiara (1977), Shetty (1978), Agarwal (1975), Rangarajan (1974). Their finding, in general, is that the north-eastern, eastern and central regions have received smaller share in rural institutional credit.

farmers with more than 10 acres of land have relatively more credit from both the cooperatives and the com...ercial banks (Table 4).

(3) Purchasing Power of Credit, and Distribution of Benefits from Concessional Lending:

Considering the real value[16] of credit and deposits over the years under study six distinct findings can be highlighted. First, reval value of both credit and deposits have increased much less spectacularly than their nominal values (Tables 1 and 5). Second, the real values of both rural credit and deposits have changed at about the same rate (Table 5). Thirdly and more importantly, the real value of both rural credit and rural deposits have declined continuously from 1971-72 to 1974-75. Against this, the purchasing power of the formal credit outstanding with all the sectors has increased almost continuously during this period except in 1974-75. This is despite the fact that the purchasing power of deposits collected from all the sectors did not increase in two of the three years (Table 5). Fourth, farmers were the worst sufferers on account of inflation. This is because real value of credit given directly to farmers declined continuously during 1971-72 to 1974-75. Against this, indeed, the real value of indirect credit actually increased (Table 5). Fifth, the relationship between real interest rate and rural credit/deposit is almost non-existent. Sixth, in two of the three years of high prices, there was a

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[16] To obtain value in constant prices nominal values were deflated by using wholesale price index with 1970-71 as the base year. The data on wholesale price index were obtained from the Reporters on Currency and Finance published by the Reserve Bank of India.

Table 4 Distribution of Rural Direct Credit

ars	Short-term Credit						Term-Credit					
	Cooperatives			Commercial Banks			Cooperatives			Commercial Banks		
	Concentration Ratio[1]	Farmer-Borrowers Owning More than 10 Acres		Concentration Ratio[1]	Farmer-Borrowers Owning More than 10 Acres		Concentration Ratio	Farmer-Borrowers Owning More than 10 Acres		Concentration Ratio[1]	Farmer-Borrowers Owning More than 10 Acres	
		% of Loan Amount	% of Accounts		% of Loan Amount	% of Accounts		% of Loan Amount	% of Accounts		% of Loan Amount	% of Accounts
1	2	3	4	5	6	7	8	9	10	11	12	13
69-70@ is on June 30)	0.63[a]	71[b]	68[b]	NA	NA	NA	0.171	49	36	NA	NA	NA
73-74@ s on March 31)	NA	NA	NA	0.300	34	15	NA	NA	NA	0.277	62	38
75-76@ s on March 31)	NA	NA	NA	0.265	27	11	NA	NA	NA	0.293	61	34
73-74* uring the year)	NA	NA	NA	NA	NA	NA	0.100	36	29	NA	NA	NA
75-76* uring the year)	NA	NA	NA	0.302	25	9	NA	NA	NA	0.369	63	30

= Data Not Available

For loans outstanding at the year end

For loans advanced during the year

Result is not fully reliable because it is based on data with two farm size groups

Refers to farmers owning more than 5 acres

Notes to Table 4

1 Concentration ratio is computed by using the formula for the grouped data:

$$C = \frac{5000 - \frac{1}{2}\sum_{i=1}^{n} (Q_i + Q_{i-1})E_i}{5000}$$

Where C = Concentration ratio

Q_i = Cumulative percentage of amount in holding size group i

E_i = Percentage of borrowers in size group i

Data Sources:

(1) Reserve Bank of India, Statistical Statements Relating to Cooperative Movement in India, Part I, Credit Societies, 1969-70 and 1973-74.

(2) Rangarajan C., "Banking Development Since Nationalization and Reduction in Disparities," Sankhya, Indian Journal of Statistics, 1974, Vol. 36, Series C, Parts 2 & 4.

(3) Reserve Bank of India, Special Returns on Agricultural Advances I, Bombay.

(4) Rao C.H.H., "Farm Size and Credit Policy," Economic and Political Weekly, 5, No. 52, December 26, 1970.

negative interest rate on rural credit. Moreover, since the negative interest rate on rural deposits, as expected, always remained higher than that on rural credit, the rural savers continued to be the losers. Due to non-availability of data it is not possible to identify whether these savers were small or large farmers.

As regards the impact of negative interest rate of rural credit on the distribution of benefits, we first estimate[17] the total amount of interest-rate subsidy received by the rural borrowers. We also find out the recipients of this subsidy among different sized-farmers. The former exercise is done for all types of rural credit. The latter exercise is attempted separately for cooperative and commercial banks' credit, because of non-availability of comparable data on credit distribution by farm-size. While the relevant data for cooperatives are available for direct loans disbursed during the two years, namely, 1973-74 and 1974-75, the data for commercial banks are available only for the outstanding direct loans for the year 1973-74. These exercises are based on the following assumptions that were largely compelled by the availability of information.

(a) The interest rate on rural credit considered here is an unweighted mean of interest rate on all types of formal rural credit;

(b) Each farmer-borrower has only one loan account with the banks[18];

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[17] For methodology used in this section see Vogel (1977).

[18] Large farmers hold land in the name of their family members also, to avoid land ceiling laws. They consequently have more than one account with the banks. An upshot of this is that the distribution of credit and that of benefits from concessional lending rates is much more skewed than what we have presented here.

Table 5 Real Value of Formal Credit And Deposits: Rural and Total, All-India (in 1970-71 Prices)

:s	Rural Credit	Total Credit	Rural Direct Credit	Rural Indirect Credit	Rural Direct Term Credit	Rural Deposits (A)	Rural Deposits (B)	Total Deposits	Direct Coop. Credit to Farmers Owning Land upto 5 Acres	Average Real Interest Rate on Rural Credit (%)	Average Real Interest Rate on Rural Deposits (%)
	2	3	4	5	6	7	8	9	10	11[a]	12[b]
-62	5,645	29,200	5,645	-	905	NA	NA	31,123	NA	5.8	3.6
-68	8,959	42,506	8,959	-	3,145	13,055	NA	50,916	NA	1.9	-2.1
-69	12,939	47,766	11,612	1,327	4,566	17,155	6,022	57,596	NA	9.2	5.7
-72	22,688	71,885	19,776	2,913	NA	25,830	10,025	82,634	NA	4.4	0.4
-73	22,563	74,905	18,745	3,818	11,352	30,413	12,080	91,360	219	0.5	4.0
-74	21,126	76,600	17,215	3,910	10,163	29,367	11,924	88,885	152	-8.7	-13.5
-75	20,155	69,679	15,573	4,582	8,998	27,310	11,203	82,940	167	-12.2	-17.7
-76	23,117	85,576	18,202	4,916	10,240	33,529	13,574	100,966	201	14.6	8.8
-77[c]	26,056	97,325	20,197	5,858	11,146	NA	NA	NA	NA	11.5	5.0

Not Available

tained by subtracting annual rate of change in wholesale price index (with 1970-71 as base year) from the average minal interest rate charged by cooperatives and commercial banks on their direct and indirect short-term and term ans to agriculture.

tained by subtracting annual rate of change in wholesale price index (with 1970-71 as base year) from the average minal interest rate offered on savings and fixed deposits by the cooperatives and commercial banks.

timated.

Sources:

Same as those listed in Table 1.

(c) At an all-India level farmers owning more than 10 acres could be called large farmers; whereas those owning less than 5 acres are small farmers;

(d) The real rate of interest that would equate the supply of and demand for credit in India would be 10 percent[19];

(e) The skewness in the distribution of benefits from interest-rate-subsidy would be highly sensitive to the fluctuations in the rate of change in prices, since such fluctuations seem to be the established fact, and since nominal interest rate in India is rather sticky.

Given the negative real rate of interest on rural credit and assuming an equilibrium real interest rate of 10 percent, the interest-rate subsidy on rural credit worked out 18.72 percent for 1973-74, and 22.20 percent for 1974-75. Table 6 also gives the corresponding rates for the direct cooperative credit and also for the commercial banks' direct credit.

Considering the amount of rural credit outstanding from both the types of formal agencies together with the interest-rate subsidy, the total subsidy was about Rs.5,525 million for 1973-74, and Rs.7,826 million for 1974-75. This subsidy amounted to little over 1 percent of India's NDP during the two years. Also, it amounted to about 2 to 3 percent of the NDP from agriculture in these two years (See Table 6).

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[19] Much before the unprecedented inflation of 1973-74, and 1974-75, the average interest rate paid by the farmers to the moneylenders ranged from 15 to 18 percent during the decade of 1951-52 to 1961-62 (Ghatak 1976

Table 6 Interest Rate Subsidy And Total Subsidy on Rural Credit 1973-74 & 1974-75

	1973-74		1974-75		
	Both Agencies' Rural Credit				
1. Average Nominal Interest Rate (%)		11.50		13.00	
2. Rate of change in wholesale Price Index(%)		20.22		25.20	
3. Average Real Interest Rate (%)		-8.72		-12.20	
4. Average Interest-Rate Subsidy (%)		18.72		22.20	
5. Rural Credit (Rs. in Million)		29,513		35,251	
6. Total Interest-Subsidy i.e. (Row 5 x Row 4)/100 (Rs. in Millions)		5,525		7,826	
7. % of Total subsidy to Net Domestic Product		1.11		1.34	
8. % of Total Subsidy to Net Domestic Product from Agriculture		2.24		2.85	
	Coops' Direct Rural Credit				
9. Average Nominal Rate of Interest (%)		10.00		11.90	
10. Average Real Interest Rate (%)		-10.22		-13.30	
11. Average Interest-Rate Subsidy (%)		20.22		23.30	
12. Coops' Direct Credit (Rs. in Million)		19,695		21,601	
13. Total Interest Subsidy (Rs. in Million)		3,978		5,033	
14. Allocation of Interest subsidy to	%	Amount	%	Amount	
(a) Large farmers	39.20	1,560	44.52	240	2
(b) Small farmers	30.90	1,229	29.71	495	
	Com. Bks' Direct Rural Credit				
15. Average Nominal Rate of Interest (%)		12.00		14.00	
16. Average Real Interest Rate (%)		-8.22		-11.20	
17. Average Interest-Rate Subsidy (%)		18.22		21.20	
18. Commercial Banks' Direct Credit (Rs.in Million)		4,355		5,636	
19. Total Interest-Subsidy (Rs. in Million)		793		1,195	
20. Allocation of Interest Subsidy To:	%	Amount	%	Amount	
(a) Large farmers	54.20	430	NA	NA	
(b) Small farmers	24.80	197	NA	NA	

NA = Not Available

The distribution of interest-subsidy on direct cooperative credit among different farm-size-borrowers reveals that in 1973-74, 39 percent of the total subsidy (of Rs.3,978 million) was received by large farmers. The corresponding figure for 1974-75 was about 45 percent (of Rs.5,033 million). These large farmers accounted for about 25-28 percent in the total borrowers in both the years.

The interest-subsidy on commercial banks' loans outstanding with the farmers during 1973-74 was Rs.430 million. Of this, 54 percent was received by the large farmers who accounted for 24 percent of the farmer-borrowers. Against this, small farmers received about 25 percent of this subsidy, although they constituted nearly 57 percent of the total farmer-borrowers (Table 6). Lastly, inasmuch as the distribution of term loans of both the agencies was more skewed than that of the short-term loans, the proportion of interest-subsidy received by large farmers was higher than that by the small farmers. The implications of such distribution of term-loans to the future income disparities among the various classes of farmers are too obvious to elaborate here.

IV

Concluding Observations

To conclude, share of rural credit in the credit outstanding with all the sectors in the seventies had increased to around 28 to 30 percent from about 20 percent in the early sixties. Similarly the share of rural deposits had grown to around 33 percent in the seventies from around 25 percent in the sixties. Both these performances appear satisfactory considering the agriculture's contribution to the national income during these years. However, since 1973-74 the shares of both rural credit and rural deposit have stagnated. Secondly, the ratio of rural credit to rural deposit also reveals the same feature. More importantly, considering the deposits collected by rural branches alone instead of by both rural and semi-urban branches the formal agencies have not been able to meet the rural credit needs from these deposits. Thirdly, even the percentage of rural credit to net domestic product from agriculture has stagnated since 1973-74. These dissenting features must be appreciated keeping in view the high dependence of rural households on the informal credit agencies.

Furthermore, the purchasing power of both rural credit and deposits had decreased more than that of total credit and deposits. The high pressure of inflation together with the growing default rate of rural credit implies erosion of capital structure of the formal agencies.

Since the real value of credit extended to the farmers declined continuously, farmers were the worst suffers on account of inflation. In respect of distribution of credit and that of benefits from the interest-rate-subsidy among farmers of different land holding sizes, the performance of the formal segment of the RFM was too desperate. Since availability of loanable funds is not a constraint to improving these performances (Shetty 1978, Ghiara 1977), what is required is the complete reorientation in the formulation and implementation of rural credit and savings programmes, besides the least emphasis on concessional lending policies. (Shetty 1976, Desai 1978a and 1978b). In this reorientation innovations are particularly needed in involving both private including money lenders and institutional agencies in financial intermediation between the banking institutions and the rural clients.

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