

Resurrection of Rural Credit*

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If the rural credit institutions find themselves in a moribund state today, this is largely attributable to the financial sector reforms introduced in the 1990s, as part of the process of liberalization and globalisation of the Indian economy. In the milieu of the new banking culture fostered by reforms, lending to agriculture or priority sectors generally, became unfashionable. The relative magnitude of the flow of credit to agriculture shrank and the interest rate regime which was designed to pamper the private corporate sector openly discriminated against agriculture. Even public sector banks (PSBs) merrily defaulted on the credit targets of 18 per cent of net bank credit to agriculture and 40 per cent of net bank credit to priority sectors. The Reserve Bank of India (RBI), which was obsessed with implementing the Basel norms as the main thrust of banking reforms, winked at the defaults. While the priority sector target has been attained during the last couple of years, the target for agriculture continues to remain unattained: lending to agriculture is around 15 per cent today, as compared to the target of 18 per cent of net bank credit. While highly rated corporate entities could raise money from banks or PSBs at interest rates as low as 6 or 7 per cent, the small farmer was required to pay a rate of 12 per cent. It was left to the Government of India to reduce the lending rate to small farmer to 8 per cent only in August 2003. RBI's neglect of agriculture and the rural sector generally was total during the 1990s: it failed to arrest the deterioration of the health of all institutions involved in rural credit: PSBs, Cooperative credit institutions and Regional Rural Banks (RRBs) – all of these institutions showed high Non-performing Assets (NPAs). In other words, the financial sector reforms which were transplanted from the so-called Basel norms were ill-concerned and unrelated to the specific socio-economic milieu of the Indian soil, and they succeeded in creating an adversarial environment for rural credit. In fact the credit-deposit ratio of RRBs declined sharply over the 1990s, indicating a reverse flow of funds from the rural to the urban areas. Even RRBs were permitted to invest in the PSU bonds. No wonder, the annual average rate of agricultural growth decelerated sharply from 4.7 per cent in the Eighth Five Year Plan to only 2 per cent in the Ninth Plan. I have documented elsewhere in detail how the reforms fad led to the sickness of the rural credit delivery system, as a¹ whole.

It is indeed gratifying to note that the Tenth Five Year Plan endorses this viewpoint: "It is being evident, however, that the organised financial sector in India is either unable or unwilling to finance a range of activities that are of crucial importance both for growth and development. Agriculture, unorganised manufacturing and services, and various types of infrastructure are instances of such sectors. The recent financial sector reforms have naturally focused primarily on improving the viability and stability of financial institutions without adequately addresses this issue. It is, therefore, necessary to consider methods of encouraging the financial sector to finance such activities, without impinging on its viability or compromising on prudential concerns"². One thing should

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¹ Financial Sector Reforms and India's Economic Development, Vols. 1 and 2, Academic Foundation, Delhi, 2002.

² Tenth Five Year Plan, 2002-2007, Planning Commission, New Delhi, Volume II, p. 293.