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INRM Policy Brief No. 3

Agricultural Marketing and Rural Credit for Strengthening Indian Agriculture

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I. Introduction

Strengthening agriculture is critical for facing the challenges of rural poverty, food insecurity, unemployment, and sustainability of natural resources. Agriculture is the science and practice of activities relating to production, processing, marketing, distribution, utilization, and trade of food, feed and fiber. This definition implies that agricultural development strategy must address not only farmers but also those in marketing, trade, processing, and agri-business. In this context, efficient marketing and rural credit systems assume added importance. Marketing system is the critical link between farm production sector on the one hand and nonfarm sector, industry, and urban economy on the other. Besides the physical and facilitating functions of transferring the goods from producers to consumers, the marketing system also performs the function of discovering the prices at different stages of marketing and transmitting the price signals in the marketing chain. The issues and concerns in marketing relate mainly to the performance (efficiency) of the marketing system, which depends on the structure and conduct of the market. An efficient marketing system helps in the optimization of resource use, output management, increase in farm incomes, widening of markets, growth of agro-based industry, addition to national income through value addition, and employment creation. The rural credit system assumes importance because most Indian rural families have inadequate savings to finance farming and other economic activities. This, coupled with the lack of simultaneity between income and expenditure and lumpiness of fixed capital investment, makes availability of timely credit at affordable rates of interest a prerequisite for improving rural livelihood and accelerating rural development.

The objective of this paper is to identify the main problems in agricultural marketing and rural credit systems and suggest policy strategies that can be implemented for strengthening Indian agriculture. The paper is divided into six sections. The main problems in the agricultural marketing system are discussed in the second section. Some priority areas for immediate attention and specific marketing policy reforms are presented in the third section. The fourth section deals with the status and main problems of the rural credit system, particularly those related to agricultural credit. Priority areas for improving the rural credit system and specific recommended strategies are presented in the fifth section. Concluding observations are given in the last section.

II. Main Problems in Agricultural Marketing

Agricultural marketing in India is characterized by pervasive government intervention. The objectives and forms of intervention have, however, changed substantially over time. State intervention in agricultural marketing is by definition aimed at correcting perceived market failures. Several instruments of such state intervention in India have their origin in the experience of the Bengal Famine, where market failure occurred due to inadequate state intervention. In the current situation of agricultural surpluses, however, market failure is occurring due to excessive state intervention.

Agricultural marketing has changed conspicuously during the last fifty years. The main reasons for this change are increased marketable surplus, increase in urbanization and income levels and consequent changes in the pattern of demand for marketing services, increase in linkages with distant and overseas markets, and changes in the form and degree of government intervention. Some basic features of the system and associated problems are:

- The market size is already large and is continuously expanding. Farmers' market linkages (both backward and forward) have also increased manifold. But the marketing system has not kept pace.
- Private trade, which handles 80% of the marketed surplus, has not invested in marketing infrastructure due to the excessive regulatory framework and dominance of the unorganized sector.
- Increased demand for value-added services and geographic expansion of markets demands lengthening of the marketing channel but this is hampered by lack of rural infrastructure.
- Direct marketing by farmers to consumers remains negligible. In the 27,294 rural periodic markets, where small and marginal farmers come to the markets, 85% lack facilities for efficient trade.
- For facilitating trade at the primary market level, 7161 market yards/sub-yards have been constructed but they are ill equipped.
- Food processing industry has a high income multiplier effect and employment potential. But in India the value addition to food production is only 7%, mainly because of the multiplicity of food-related laws.
- Due to poor handling (cleaning, sorting, grading and packaging) at the farm gate or village level, about 7% of grains, 30% of fruits and vegetables and 10% of seed species are lost before reaching the market.
- An estimated Rs. 50,000 crore are lost annually in the marketing chain due to poorly developed marketing infrastructure and excessive controls.
- State Agricultural Produce Markets Regulation (APMR) legislation hampers contract farming initiatives, which otherwise can be highly successful.
- Farmers shifting to higher-value crops face increased risk of fluctuation in yield, price and income.
- While agricultural price policy and associated instruments have induced farmers to adopt new technology and thereby increase physical and economic access to food, they have reduced private sector initiative and created several other problems in the economy.

III. Priority Areas in Agricultural Marketing

Based on the problems identified in the earlier section, six areas need priority attention.

Regulation of Agricultural Produce Markets

To improve the marketing system of farm products wholesale agricultural produce markets began to be regulated in the 1950s and 1960s. Based on a Model Act circulated by the central government, almost all major states (27) enacted APMR legislation. This legislation covers 7161 markets, which cover more than 98% of the identified wholesale markets in the country.

Various studies on the impact of regulated markets (Acharya, 1985, 1988; Agarwal and Meena, 1997; and Suryawanshi et al., 1995) have highlighted several positive features of the regulation program. These include a visibly open process of price discovery, more accurate and reliable weighing, standardized market charges, payment of cash to farmers without undue deductions, dispute settlement mechanism, timing and sequencing of auctions, reduction in physical losses of produce, and availability of several amenities in market yards.

In the emerging scenario, however, the relevance of the market regulation program seems to have declined. A comprehensive study of the agricultural marketing system during the last fifty years by Acharya (2004) identifies several problems associated with regulated markets. For example, since the agricultural produce marketing committees (APMCs) do not allow the traders to buy from the farmers outside the specified market yards or sub-yards, the cost of marketing increases. Also, the area served per market yard is high, the national average being 459 sq. km., and considerably higher in states like Assam, Himachal Pradesh, Orissa, Madhya Pradesh, and Rajasthan. The long travel distance involved to reach a marketplace is a disincentive for most farmers, with small surplus to sell. Several markets are also poorly equipped. Apart from the primary assembling markets, there are 27,294 rural periodic markets, where small and marginal farmers and livestock owners come in contact with the market economy. Most of these (85%) have not been developed, which hinders the market orientation of rural areas. In several states, since elections of APMCs are not regularly held, they are superseded by the government and administered by bureaucrats, depriving them of the characteristic of being farmer-dominated managerial bodies. The staff remains overly occupied with the collection of market fees and construction work rather than market development. Congestion in the market yards delays the disposal of the farmers' produce, frustrating the farmers. In several markets, malpractices by traders persist, such as late payment, deduction for cash or spot payment, and nonissue of sale slips. In some markets market functionaries (traders, commission agents, and laborers) have formed strong associations, barricading the entry of new functionaries. A considerable part of the market fee, which by definition is the charge for the services provided to market functionaries, is not plowed back. In some states, this has even become a source of revenue for the government. By and large, APMCs have emerged as some sort of government-sponsored monopolies in the supply of marketing services/facilities, with all the drawbacks and inefficiency associated with public sector monopolies.

The matter has been under continuous scrutiny during the last five years. On the recommendation of the Expert Committee for Agricultural Marketing (GOI, 2001), the Inter-Ministerial Task Force (GOI, 2002a) recommended the formulation of another Model Act for this purpose. The Department of Agriculture and Cooperation, Ministry of Agriculture has, in consultation with state governments, trade and industry, circulated this Model Act to the states (GOI, 2004).

The Model Act is comprehensive. When adopted, it will help improve the efficiency of the marketing system and encourage private sector investment in agricultural marketing but both state governments and traders/commission agents are resisting its adoption. Only a few states have adopted the model, and that partially. State APMCs fear losing market fee if alternative markets are established. Traders/commission agents fear losing their business/incomes. Several options are available to allay such fears. The contractors (under contract farming) can assure payment of market fee to APMCs. The latter can declare more sub-yards to be managed by cooperatives or private entrepreneurs. In the village sub-yards, private sector companies or associations can create cleaning, sorting, grading and packaging facilities, employing rural youth. The traders/commission agents may be persuaded to organize into groups or work as individuals as agents of contractors.

In the 1950s, it took 10 to 15 years for the major states to adopt the original model of APMR legislation after it was circulated. This time, with adequate sensitization of all stakeholders, the revised Model Act can be adopted by states in a relatively short period. Two proactive measures may promote this objective: (i) the central government should launch a massive campaign to publicize the benefits of amendments in state APMR legislation and to sensitize key stakeholders (farmers, traders, processors, consumers and panchayati raj institutions (PRIs)); (ii) it should also announce a package of grant to states to compensate for possible loss in market fee and linking the package to the amendment in their APMR legislation on the lines of the Model Act.

Independent of amendments in state APMR legislation, certain problems in the functioning of APMCs require immediate attention. These pertain to bureaucratization of market committees, not plowing back market fees for market development, and cartelization of traders and market functionaries. The overemphasis of market committees on collection of market fees rather than promotion of marketing efficiency also needs attention. To this end, the state governments should be persuaded to act on the following lines:

- Holding regular elections of market committees.
- Compulsory plowing back of market fees for development of marketing facilities.

- Liberalization of licensing of traders and market functionaries.
- Promotion of grading, standardization and quality certification.
- Creating cleaning, sorting, grading and packaging facilities in villages and allowing traders to buy in the villages by declaring these places as sub-yards.

Simplification and Rationalization of Regulations Related to Marketing and Food Processing

Apart from the regulation of primary wholesale markets, several other legal instruments were enacted by the central government and the states to influence the conduct of the market (Acharya, 2004; GOI, 2002a). An illustrative list of 222 such enactments is available in Acharya and Agarwal (2004) and GOI (2002a). Several of these enactments have been repealed, rescinded or lifted during the last five years. There are also at least fourteen enactments governing food-processing activity, administered by fifteen different departments and ministries.

The unfinished agenda of domestic agricultural marketing reforms would need to take the following into account:

- Despite deregulation, small-scale low-technology firms established under the old restrictive laws still dominate the food processing industry.
- Licensing requirements, stocking limits and movement restrictions for major agricultural products have only been temporarily removed. In some states these restrictions still prevail in effect. The threat of their reimposition discourages both domestic and foreign investment (Landes and Gulati, 2004).
- Also, restrictions on investment in bulk handling and storage have been removed only temporarily. Though investment incentives have been provided the private sector is hesitant to invest in bulk handling and storage.
- Despite automatic approval of foreign equity up to 100% in food processing, the multiplicity of food laws hampers the investment potential. The Unified Food Law is yet to be formalized and put in place.
- Restrictions on sale of sugar by sugarcane processors continue, though at a reduced level. The government levies 10% of the sugar output. The remaining free-sale part is also subjected to controlled releases in the market.
- Small-scale reservation on groundnut and mustard processing continues (World Bank, 2004).
- Restrictions on futures trading in livestock products continue (World Bank, 2004).
- Monopsony procurement of raw cotton in Maharashtra is still in place, which hampers free marketing of raw cotton in the country.

The uncertainty created by the unstable regulatory environment has discouraged private sector investment in supporting marketing infrastructure, agro-processing, and agro-industry, that could have expanded demand for primary agricultural products and generated employment in rural areas. The potential for growth in the food processing subsector can be exploited by quickly enacting the Unified Food Law. A draft Integrated Food Law is now under the consideration of Parliament. The objective should be to make food laws more industry-friendly and move from multi-level and multi-departmental control to integrated line of command and integrated response to strategic issues, regulations, and enforcement. Greater reliance needs to be placed on self-compliance by the industry rather than regulatory regime. Several food-related laws need to be repealed and several others modified to encourage the growth of the food processing sector, which will help both farmers and consumers.

Withdrawal of restrictions on storage, movement, bulk handling, and other activities being temporary, investment from both domestic and foreign investors is not flowing into the sector. To allay fears of reimposition of such restrictions either the Essential Commodities Act can be replaced with a simplified legislation which empowers the government to impose such restrictions only during an emergency or the withdrawal of restrictions widely publicizing to allay investors' wariness.

It is recommended that (a) the provisions in the Draft Food Safety and Standards Bill 2005 (brought out by the Group of Ministers) should be expeditiously passed by Parliament after due consideration; and (b) to allay the fears of reimposition of restrictions, either the Essential Commodities Act should be replaced with simplified legislation empowering the government to impose such restrictions only during an emergency or the withdrawal of restrictions should be given wide publicity.

Agricultural Price Policy and Food Management

Agricultural price policy has considerably influenced the marketing system of agricultural commodities. The policy was primarily intended to stabilize agricultural prices and influence the price spread from farm gate to the retail level. Its objectives, thrust, and instruments have conspicuously shifted during the last fifty years.

By creating a fairly stable price environment the policy has been instrumental in inducing the farmers to adopt new production technology and thereby increase output. Geographically dispersed growth of cereal production, coupled with public distribution system (PDS) of cereals, helped in increasing physical access to food. Supply of subsidized inputs to farmers and subsidized distribution of foodgrains pushed down the real prices of staple cereals vis-à-vis per capita incomes, which improved economic access to food. These policy measures also enabled the organized sector and industry to keep their wage bills low, as cereals have a considerable weightage in the consumer price index. The benefits of price policy and input/food subsidies have, thus, been shared by all sections of society, i.e. surplus-producing farmers, farmers deriving their entitlement from production, other farmers who are net purchasers of foodgrains, landless laborers, urban consumers, and industry (Acharya, 1997, 2000).

Even so, some important emerging problems related to agricultural price policy and food management system may be noted:

- During the last six to seven years, the government fixed the minimum support prices (MSPs) of rice and wheat at levels much higher than recommended by the Commission for Agricultural Costs and Prices (CACP) (Acharya and Jogi, 2003). This led to accumulation of excessive stocks and also raised the public cost of foodgrain policy. With coalition governments being the more likely political dispensation in the future, the likelihood of considerations of political economy outweighing rational factors in determining the level of MSPs also increases.
- Foodgrain stocks with the government also increased because of frequent relaxation of fair average quality (FAQ) norms, inappropriate timing of raise in issue prices of grains for PDS, and improper meshing of export-import policy. Currently, however, the stocks are below or close to the minimum prescribed levels.

- For sugarcane, many state governments have been fixing what may be called 'state advised prices' (SAP), much higher than the statutory minimum prices fixed by the Center. Sometimes the sugar industry finds them unremunerative. SAPs, coupled with the policy of levy on sugar factories, has frequently led to piling up of cane price arrears and ultimately to the phenomenon of sugarcane/sugar cycles in the country.
- Other than in Punjab, Haryana, western Uttar Pradesh and Andhra Pradesh, price support operations for rice and wheat are not being implemented in some states. A result has been that surpluses have emerged during the last decade, but farmers could not get the MSP for their produce. This happened mainly because the nodal agency (Food Corporation of India, FCI) and state agencies in the new emerging surplus states are not geared to undertake price support operations. The FCI remains occupied with large volumes of purchases in traditional surplus-producing states. Some decentralized procurement and refocusing the operations of FCI to nontraditional states may help in this regard.

One other issue in the context of food management system is the reduction in incentives for private sector participation in foodgrain trade. The price policy and related programs reduced private sector incentives for spatial and temporal arbitrage. For example, for rice and wheat, the intra-year price rise has been considerably lower than the storage cost. It is true that private sector participation in foodgrain trade was reduced due to FCI's operations but FCI's operational costs are not higher. FCI's efficiency vis-à-vis private trade in price support operations and subsequent distribution of foodgrains has been questioned in this context on the ground of its economic cost and consequent outgo on food subsidy. This merits discussion.

First, both the MSP and issue price are determined by the central government. Second, it has been shown (Acharya, 1997) that 71.6% of the FCI's expenditure on procurement and distribution is on items which are determined outside the system. The High Level Committee on Long-Term Grain Policy has put 69% of the economic cost of FCI as policy-induced costs (GOI, 2002b). These include *mandi* charges, purchase/sales tax, cost of gunny bags, interest on working capital, and freight rates. Private trade will also have to incur these costs unless it can evade some of the statutory taxes/charges (Acharya, 1997). Third, losses during storage and transit are estimated at around 1%, which are not unduly high as compared to private channels. Fourth, FCI's establishment charges and administrative overheads, estimated to be 2.8% of the economic cost, are not higher than the net margins of private trade. Fifth, a recent study commissioned by the Union Ministry of Consumer Affairs, Food and Public Distribution (Chand, 2003) has shown that to attract private trade to buy wheat and paddy from the markets in surplus producing states, the retail prices during lean months in deficit states ought to rule at more than twice the peak season wheat prices of surplus states. This ratio was estimated as more than three for paddy/rice. These ratios are not less than the ratio of FCI's economic cost of wheat/rice to the respective support prices. The findings of the High Level Committee on Long-Term Grain Policy (GOI, 2002b) are on similar lines. The committee has observed that the margin required for private trade to move grain from rural to urban areas of the same state is similar to FCI's distribution margin, which involves an average transport lead of more than 900 km. Sixth, the Chand study has suggested retention of a public agency to handle foodgrain trade, because in its absence private trade may turn exploitative.

Considering all the pros and cons, it is recommended that

- A statutory status should be assigned to the CACP and to its recommended MSPs to curb the tendency of fixing MSPs much above the rational level.
- Instruments of price policy that have outlived their utility should be phased out. These are: (a) levy on rice millers; (b) levy on sugar factories; (c) state advised prices of sugarcane; (d) control on release of free-sale quota of sugar; and (e) monopoly procurement of raw cotton in Maharashtra.
- Price support purchases of cereals should be decentralized to make price support effective in all states. Specifically, (a) in states like Punjab and Haryana, greater responsibility should be given to state agencies; (b) FCI should concentrate its efforts in states where state agencies are not fully equipped and geared; and (c) price support operations and subsequent disposal of coarse cereals should be delegated to state governments, with financial back-up from the central government.
- Targeted PDS has several positive features. Problems of leakage and subsidized grains not reaching the intended sections can be checked by publicizing the prices, list of targeted beneficiaries, and stock position of grains at fair price/ration shops and village panchayat offices and making gram panchayats or local bodies responsible for monitoring.

Reduction of Farmers' Marketing Risks

Farmers face both yield and price risks. Yield or production risk can be covered by crop insurance and weather or rainfall insurance. For marketing risks, three instruments are available. One is MSP. Notwithstanding the defects in its implementation, it has helped a large number of farmers in surplus producing states to cover a part of their price risks. Effective implementation of MSP policy, as suggested earlier, will help farmers reduce their price risks.

A second instrument for covering price risk is the emerging scenario of contract farming arrangements, which are in a way future contracts on prices. There are several success stories relating to such arrangements. A precondition for contract farming to expand is amending state APMR legislation. This apart, a Model Contract has also been formulated and circulated to states. However, several complementary measures are needed for contract farming to expand on a large scale. It will need (a) organization of farmers'/producers' groups; (b) legislation and effective implementation of a contract law; (c) improvement in the quality of input delivery and research and extension services; (d) training of farmers in maintenance of quality standards; (e) provision of complementary infrastructure, including IT kiosks (like e-choupal) in rural areas; and (f) development of an effective land record and administration system. This will also require identification of a group of villages for each niche commodity and provision of credit and incentives for the farmers to shift to the identified commodity.

A third instrument is the farm income insurance scheme (FIIS), introduced on a pilot scale in eighteen districts during Rabi 2003-4 and extended to one hundred districts of sixteen states during 2004-5. FIIS covers both price and yield risks. The scheme is compulsory for loanee farmers but optional for others. If successful, FIIS will replace the National Agricultural Insurance Scheme (NAIS) but NAIS will continue in uncovered districts. The government has announced a subsidy on premium up to 75% for marginal and small farmers and 50% for other farmers. The success of this laudable scheme will depend on the speed with which the estimates of area, yield and prices realized by the farmers are arrived at. These parameters both at area and individual farmer's level are not easy to compile objectively. Further, the guaranteed level of income is also based on indemnity of 80% of moving average of seven years of actual yield. Statistically reliable yield estimates below the district level are not available and special yield estimation surveys at sub-district or lower levels have all the limitations of losing objectivity. The experience of pilot tests of FIIS has not yet been made available. Whatever may be the outcome of pilot testing, the long-term solution for insuring farmers' risk is an effective FIIS. Till it is put in operation in all the areas covering every farmer, a combination of MSP policy, contract farming and crop/livestock insurance scheme would need to continue.

Farmers' Organization and Capacity Building

Farmers will benefit from deregulation of markets, minimum guaranteed price scheme, contract farming or crop/income insurance only to the extent they organize in marketing groups, self-help groups, cooperatives or companies and learn skills suited to the new marketing environment. Understanding quality standards (including FAQ), learning the terms of contract and insurance, and choosing and preparing the produce for the market are going to be essential skills for farmers. State marketing departments, APMCs, marketing cooperatives, nongovernmental organizations (NGOs) and PRIs should pay increasing attention to capacity building and organizing farmers for marketing in the new environment.

Complementary Public Investment in Marketing

Substantial investment in agricultural marketing infrastructure is necessary. The Expert Committee on Agricultural Marketing had estimated an investment requirement of Rs. 268,700 crore during the current decade. Nearly half of this is projected to be made by the private sector. To induce the private sector to invest, apart from the conducive regulatory framework (as suggested earlier), public investment in certain marketing facilities is necessary. Table 1 sums up the public sector investment necessary to attract private investment.

Table 1. Required Public Sector Investment to Attract Private Investment (Rs. in billion)

Item	*Public (Centre + State)*	*Private*	*Total*
Rural roads	740	—	740
Market yards development	60	—	60
Fruits and vegetable markets	10	—	10
Rural periodical markets	21	—	21
Cleaning and grading in villages	19	1	20
Storage	27	27	54
Cold storage	68	202	270
Reefer vans	1	5	6
Export-oriented agricultural zones	2	4	6
Processing and value addition	375	1125	1500
Total	1323	1364	2687

While the process of deregulation and amendment in APMR legislation is ongoing and farmers are increasingly getting organized, the public investment schemes should be put in operation to improve investor sentiment. In this connection, the recent announcement of a central sector scheme for setting up of markets and rural godowns in left-out areas is a welcome development.

IV. Main Problems in Rural Credit System

- There is considerable unmet demand for rural credit. Local moneylenders continue to provide credit to the rural families, as the reach of institutional agencies to weaker sections has remained poor. Meeting the credit needs of 25 million nonfarm informal sector enterprises continues to be a challenge to the rural financial institutions (RFIs). Though the coverage of micro-finance scheme has expanded, still around 70% of the poor are out of this network. The micro-finance sub-sector of institutional credit has not explicitly targeted the agricultural sector. RFIs have bypassed tenants and sharecroppers. More than 60% of the farm families are yet to receive the Kisan Credit Cards.
- The rate of interest charged by RFIs from farmers is considerably higher than that charged by financial institutions from urban

consumers. This is beyond the means of owners of small or marginal farms, which are nonviable or viable at the margin, and the self-employed in the informal sector. Despite an understanding reached between the Indian Banks' Association and the government in the presence of the Reserve Bank of India (RBI) that crop loans will carry single-digit interest, banks were reportedly charging 12% to 14% interest.

- On the supply side, RFIs are under stress, particularly since the financial sector reforms of 1992-93. Commercial banks view rural financing as costly and cumbersome. Their transaction costs are high at an estimated 6% to 7% of loans advanced (Gulati and Bathla, 2002). One reason for these high transaction costs is the corporate culture of these banks. To bring down costs, they are focusing on selected clientele of large borrowers. The bank staff is not motivated to go to rural branches. Many commercial banks have closed nonviable rural branches because of rising nonpaying assets and the high cost of rural lending.
- Up to the middle of the 1980s, regional rural banks (RRBs) enjoyed a cost advantage vis-à-vis the commercial banks but by the late 1980s they lost this advantage. Their transaction costs have also now gone up to 6% or 7% of advances. They are too strongly tied to their sponsor banks and have little freedom of operation.
- Cooperatives, though their scale of lending and reach to rural areas is outstanding, work more as channels of credit than banks. Their efforts to mobilize deposits are inadequate. Even otherwise, the depositors in cooperative banks have no safeguards. There are three main problems with cooperative RFIs. First, their financial position is precarious. Some time ago, the government had sanctioned Rs. 15,000 crore for recapitalization of cooperative banks but on second thought the matter was referred to another committee (A. Vaidyanathan). Second, a three-tier hierarchy and absence of de-layering comes in the way of rural lending. Third, excessive bureaucratic control and politicization has compromised their democratic character and efficient functioning.
- This apart, widening of the scope of the priority sector has affected agricultural lending. The RFIs' linkages with input supply or output marketing institutions have remained weak. With the introduction of the Rural Infrastructure Development Fund (RIDF) scheme, commercial banks have tended to park funds under RIDF rather than direct lending for agricultural purposes.
- There is also a problem of inter-regional differences in the reach of RFIs. In the north-eastern states, the network of RFIs is relatively weak. The micro-finance program is also concentrated in a few states.
- Another problem is of delays in processing loan applications, particularly by commercial banks. It has been reported that during 2003-4, the commercial banks received 746,696 loan applications, sanctioned only 451,458, and made actual disbursement to only 419,995 applicants. Matters were reported to be even worse during 2004-5.

V. Priority Areas in Rural Credit

Several committees have been constituted in the recent past to suggest ways to improve the flow of institutional credit in rural areas. These include the Expert Committee on Rural Credit (V.S. Vyas), Committee on Agricultural Credit though Commercial Banks (R.V. Gupta), Committee on Cooperatives (Vikhe Patil), Advisory Committee on Flow of Credit to Agriculture (V.S. Vyas), and Task Force on Revival of Cooperative Credit Institutions (A. Vaidyanathan). The government has implemented several of their suggestions. However, based on an analysis of current status and identification of concerns in the earlier sections of this paper, five areas of policy reforms and priority action are as follows:

Credit Policy

- There should be no attempt for a uniform RFI system throughout the country. The system should be flexible and decentralized, suited to the local socioeconomic milieu.
- Policy emphasis on small borrowers should continue, otherwise they may get systematically further discriminated against in credit allocation.
- A national consensus should be evolved among the political parties not to politicize the RFIs and to resist announcing of loan or

interest waiver schemes and encouraging nonrepayment of institutional loans.

- State governments should amend land laws to record tenants and sharecroppers to make them eligible for institutional credit.
- As recently announced by the RBI, the Service Area Approach (SAA) should continue exclusively for the implementation of government-sponsored programs.
- State governments should institutionalize warehouse receipt to make it an instrument for borrowing credit from institutional agencies.
- As the poor need the help of informal institutions to deal with credit institutions, NGOs, PRIs, and voluntary groups should be actively involved in the institutional credit delivery mechanism. The exact model of involvement should be area- and context-specific. This may also help in reducing the transaction costs of RFIs.

Increasing Credit Flow and Reducing Risk

Experience shows that group approach to lending is cost-effective, the rate of recovery is high, and reduces the lender's risk. Keeping this in view, credit flow in rural areas can be increased by adopting one or a combination of the following:

- Promotion of groups of homogeneous borrowers (produce based, service based, caste based, village based, cluster based, vertically integrated or horizontally integrated).
- Tying up lending with input supply agencies, output marketing firms or processors, i.e. interlocking of credit with input and commodity marketing.
- Organizing and linking farmers with contractors under contract farming arrangements and in-building credit delivery under the contract.
- Linking production credit with credit for post-harvest operations like sorting, grading, packaging, and marketing in groups.
- Involving NGOs or rural educated youths in organizing farmers or rural families in groups, scrutinizing applications, disbursement of loan and effecting recoveries, which may help RFIs in reducing lending costs.

- With increasing diversification of agriculture, along with the demand for credit, risks for both lenders and borrowers are increasing. To cover such risks, apart from group lending, insurance is emerging as an important instrument. The insurance premium (for crop insurance, weather insurance or income insurance in some areas) is also subsidized. Mass awareness program for popularizing insurance schemes should be launched for increasing their coverage.
- Lending should be liberally done for IT kiosks, agro-service centers, agri-clinics, farm nurseries, production of organic manures, cultivation and processing of Jatropha (bio-diesel) and medicinal plants/herbs, organic farming, seed production, food processing, processing of minor forest products (MFPs), custom hire services, grading/packaging equipment, street vending, refrigerators, cool chambers, electronic and electric spare parts/services and such ventures.
- To encourage the flow of institutional credit for rural nonfarm activities, a Rural Credit Card Scheme (RCCS) on the lines of Kisan Credit Card Scheme (KCCS) should be introduced.

Lending by Commercial Banks

- With greater autonomy and private sector participation in public sector banks, the institutional structure of branch network should not be diluted.
- As most new banks lack the capacity to either appraise or effectively supervise lending, specialized support agencies need to be developed or earmarked on sectoral as well as regional basis to help them meet their mandatory lending requirement efficaciously.
- The banks should recruit agricultural graduates for rural branches and should take the help of local NGOs, self-help groups or village development functionaries in the appraisal of loan applications to save time and cost.
- Banks should tie up with the corporate sector, processors, contractors under contract farming arrangements and related firms for funding farmers and thereby linking marketing with credit. For establishing such linkages banks should also take the initiative in organizing the farmers into homogeneous groups.

- The interest rate on RIDF should be related to the degree of shortfall from mandatory lending. If shortfall is higher, the interest on RIDF deposit payable to the bank by the National Bank for Agriculture and Rural Development (NABARD) should be lower.
- The requirement that lending for storage unit is treated under indirect lending only if it is located in a rural area should go.
- The limit of 4.5% on indirect lending (within 18%) should be maintained. However, lending in indirect channels by commercial banks should qualify for 40% mandatory lending for the priority sector.
- The mandatory target of 18% and 40% should be reviewed every five years.

Lending by RRBs

- RRBs should be given greater autonomy and flexibility in planning and lending policies, to restore their comparative advantage in rural lending.
- They should take the initiative in organizing farmers into homogeneous groups or farmers' companies for linking credit with input supply and output marketing.

Lending by Cooperatives

- The cooperative credit system should be rejuvenated by recapitalization and giving the cooperatives greater autonomy and infusing greater professionalism. A package of Rs. 15,000 crore, as recommended by the Task Force (submitted in January 1995) should be expeditiously implemented.
- States should be allowed to borrow from RIDF for meeting their share for recapitalization of cooperative banks.
- For imparting greater autonomy and accountability to cooperatives, states should adopt the Model Bill suggested by the Chaudhary Brahma Prakash Committee. Also, cooperative banks should be brought under the supervisory control of RBI/NABARD.
- The cooperative credit system should be de-layered, i.e. where district central cooperative banks (DCCBs) are weak, state cooperative banks (SCBs) should finance directly to primary agriculture credit societies (PACSs), and where PACSs are weak, DCCBs should finance directly to farmers. Nonviable DCCBs and primary cooperative agriculture and rural development banks (PCARDBs) should be liquidated. Also, weak DCCBs should be taken over by SCBs.
- States should be persuaded to take follow-up action on the Multi-State Cooperatives Act, passed in 2002.
- PACSs should be asked to mobilize deposits, conduct open forum meetings, take initiatives in nurturing self-help groups of their areas and introduce a system of audit by professionals.
- While the term-lending credit structure and short-term credit structure within cooperatives should be integrated, care should be taken that the already weak long-term credit structure does not weaken the short-term credit structure. Several options are available. One is to permit short-term credit institutions to disburse long-term credit. Two, strong long-term institutions can be merged with short-term institutions. Three, very weak long-term institutions may be liquidated. Four, to those long-term institutions which are neither too weak nor strong, three to five years package may be given to improve; when they become viable, they may be merged with short-term institutions.

VI. Concluding Observations

Attempts to strengthen Indian agriculture must address not only farm production (farmers) but also processing, marketing, trade, and distribution. We must link farmers to markets. In this endeavor, marketing and rural credit systems are extremely important. Indian agricultural marketing and rural credit systems have undergone several changes during the last decade. However, in the emerging environment, these need many more changes for making the agricultural sector vibrant and responsive to the aspirations of the rural masses. The suggested agenda for reforms includes (i) revision in the state APMR legislation, (ii) redefining the role of state marketing boards and market committees, (iii) repeal of ECA except under emergencies, (iv) putting in place a unified food law, (v) introduction of new instruments like contract farming and warehouse receipt system, and (vi) assurance to investors that regulations will not be reimposed. The policy of price support needs to be rationalized and decentralized. CACP and support prices should be given statutory status. Complementary public investment in marketing infrastructure should be made. The system of training farmers by strengthening the marketing extension education network needs to be put in place. Instruments for insurance of farmers against production and price risks should be made an essential component of development strategy. In the field of credit delivery, the financial institutions are under stress, particularly since the financial sector reforms of 1992-93. The credit policy should continue to emphasize small borrowers. Commercial banks are wary of lending to the agricultural sector and rural poor. The provisions of mandatory lending for the priority sector and agricultural activities should continue. Banks should take the help of NGOs and local formal institutions in their lending programs to reduce transaction costs. These apart, effective linkages between farmers and processors on the one hand and between processors and credit agencies on the other should be promoted. Interlocking of credit and product/input markets is crucial and should be recognized. To meet the credit needs of the poor, programs like linking of self-help groups with lending agencies are important but in these linkages, the role of promoting institutions should not be lost sight of. Marketing and institutional credit systems have always remained critical for agricultural development. Their role has been enhanced in the liberalized economic environment. The set of reforms and strategic actions suggested in this paper will help these systems strengthen Indian agriculture.

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