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High Ratio of Agriculture NPAS In Priority Sector Lending By Public And Private Banks In India – Reasons, Suggestions And Discussions

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Abstract: ***Agriculture is a very important sector in India .In fact it is the life and blood of our economy. Despitehaving so much importance, it is increasingly facing various problems, which arise from inadequate technologies, indifferent attitude of the government, socio-economic condition of farmers and the credit systems prevalent in India. Government and banks are continually working for development of this sector, but certain inherent challenges and risks such as high number of non-performing assets ("NPAs") are posing problems. In order tosolve these problems it is important that certain alternative methods as extension agriculture activities and fair price mechanisms should be practiced. This paper aims to first throw light on some systemic reasons behindthe high number of NPAs in the agricultural sector, and thenoffer suggestions to reduce them.***

Keywords: Agriculture, Credit, Non-Performing Assets, Priority sector, direct and indirect finance.

1. Introduction

Agriculture still dominates the Indian Economy. About 60% population of India is engaged in agriculture and contributes15% to the GDP. The importance of credit in agriculture may be gauged from the relatively lower rate of growth witnessed in this sector as compared to the other sectors of the economy.

Indian farmers can be divided into two segments- the *first* one is developed, that has switched to modern methods of agriculture and faces comparatively fewer problems in obtaining finance from banks and financial institutions. The *other*one is the deprived sector, which is still using primitive methods of production and facesmyriad problems in obtaining agricultural credit. However, there is a need to identify the problems faced by each these segments and suggest solutions for their upliftment where necessary and for the already uplifted segment, to ensure consistent growth.

2. History of Agricultural Credit

Development in agriculture credit systems has historicallybeen sluggish because of various challenges faced by our agricultural sector. Some of the challenges are (i) intermittent failure of monsoons; (ii) practice of unscientific methods of farming; (iii)underdevelopment of alternative farming systems; (iv) rural indebtedness; and (v) other associated risks.

2.1. A Brief Timeline

a. *1934*- The Reserve Bank of India Act, 1934(the "**RBI Act**") gets enacted, withspecific provisionsin relation to agriculture credit.
b. *1935*- The Reserve Bank of India (the "**RBI**")setsup an Agriculture Credit Department.
c. *1965*- Agriculture Refinance Corporation set up to provide funds by means of refinance.
d. *1995-96* - Rural Infrastructure Development Fund, or RIDF set up in 1995-96.
e. *POST 1991 Summary*

(i) Deregulation of interest rates of co-operatives and Regional Rural Banks(“RRBs”)
(ii) Deregulation of lending rates of commercial banks for loans above ` 2 lakhs
(iii) Recapitalisation of select RRBs
(iv) Introduction of prudential accounting norms and provisioning requirements for all rural credit agencies
(v) Increased refinance support from RBI and capital contribution to NABARD
(vi) Constitution of the Rural Infrastructure Development Fund (RIDF) in NABARD for infrastructure projects
(vii) Introduction of the Kissan Credit Card ("KCC") and stipulation of interest rate not exceeding 9 per cent per annumfor crop loans up to `50,000 extended by the public sector banks.
(viii) Agriculture finance introduced in the public and private sector banks.

3. Agriculture Financing Categories

According to RBI, agriculture financing is of two types– Direct Finance and Indirect Finance.

3.1. Direct Finance

The following are generally covered within the scope of direct finance:
(i) Loans to individual farmers [including Self Help Groups ("**SHGs**") or Joint Liability Groups ("**JLGs**"), i.e. groups of individual farmers] engaged in agriculture and allied activities, *viz.*, dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture;
(ii) Loans to corporates including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, *viz.*, dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture up to an aggregate limit of ₹2 crores per borrower;
(iii) Loans to small and marginal farmers for purchase of land for agricultural purposes;
(iv) Loans to distressed farmers indebted to non-institutional lenders; and

(v) Bank loans to Primary Agricultural Credit Societies ("**PACS**"), Farmers' Service Societies ("**FSS**") and Large-sized Adivasi Multi Purpose Societies ("**LAMPS**") ceded to or managed/ controlled by such banks for on-lending to farmers for agricultural and allied activities.

3.2. Indirect Finance

The following are treated as indirect finance:

(i) If the aggregate loan limit per borrower is more than ₹2 crores in respect of point (ii) under 'direct finance' above, the entire loan will be treated as indirect finance to agriculture;

(ii) Loans up to ₹5 crores to Producer Companies set up exclusively by only small and marginal farmers under Part IXA of Companies Act, 1956 for agricultural and allied activities;

(iii) Bank loans to FSS and LAMPS;

(iv) Finance for setting up of Agriclinics and Agribusiness Centres; and

(v) Loans for construction and running of storage facilities (warehouse, market yards, godowns, and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.

4. NPAs in Agriculture Finance in Public and Private sector banks

NPA is defined as a credit facility in respect of which the interest and/or installment of principal has remained 'past due' for a specified period of time.

4.1Norms

As a part of prudential norms framework for banks , norms for income recognition, classification of assets and provisioning of NPA's were introduced by RBI in year 1992-93.The extant norms for classification of agriculture loans as NPA for commercial banks are as follows:-

Case1: If the instalment of principle or interest thereon remains overdue for two crop seasons for short duration crops.

Case2: If the instalment of principle or interest thereon remains overdue for one crop seasons for long duration crops.

4.2 Level of the NPA's of agriculture in priority sector finances

Priority sector refers to those sectors of the economy which may not get timely and adequate credit. Typically these are small value loans to farmers for agriculture and allied activities, micro and small enterprises, housing loans for the underprivileged people, students educational loans and in general, loans to the low income groups and the otherwise weaker sections of the society.

4.2.1.Categories of Priority Sector

(i) Agriculture (Direct and Indirect finance): Direct finance to agriculture shall include short, medium and long term loans given for agriculture and allied activities (dairy, fishery, piggery, poultry, bee-keeping, etc.) directly to individual farme₹ Indirect finance to agriculture shall include loans given for other agriculture and allied activities.

(ii) Small Enterprises (Direct and Indirect Finance): Direct finance to small enterprises shall include all loans given to micro and small (manufacturing) enterprises engaged in manufacture/ production, processing or preservation of goods, and micro and small (service) enterprises engaged in providing or rendering of services, and whose investment in plant and machinery and equipment (original cost excluding land and building and such items as mentioned therein) respectively, does not exceed the amounts specified in Section I, appended. The micro and small (service) enterprises shall include small road & water transport operators, small business, professional & self-employed persons, and all other service enterprises. Indirect finance to small enterprises shall include finance to any person providing inputs to or marketing the output of artisans, village and cottage industries, handlooms and to cooperatives of producers in this sector.

(iii) Retail Trade shall include retail traders/private retail traders dealing in essential commodities (fair price shops), and consumer co-operative stores.

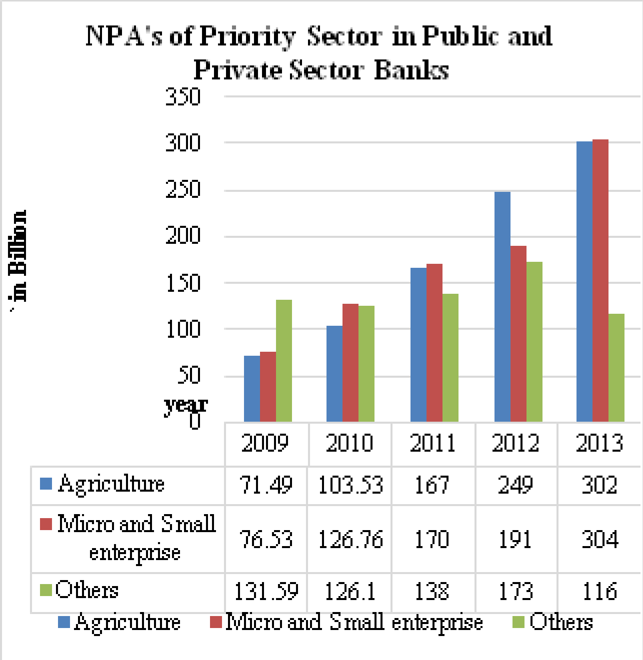
(iv) Micro Credit: Provision of credit and other financial services and products of very small amounts not exceeding ₹ 50,000 per borrower, either directly or indirectly through a SHG/JLG mechanism or to NBFC/MFI for on-lending up to ₹ 50,000 per borrower, will constitute micro credit.

(v) Education loans: Education loans include loans and advances granted to only individuals for educational purposes up to ₹ 10 lakhs for studies in India and ₹ 20 lakhs for studies abroad, and do not include those granted to institutions.

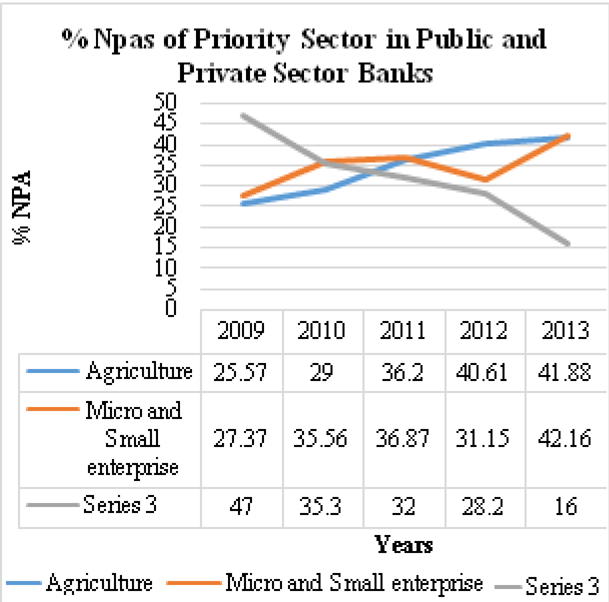
(vi) Housing loans: Loans up to ₹ 20 lakh to individuals for purchase/construction of dwelling unit per family, (excluding loans granted by banks to their own employees) and loans given for repairs to the damaged dwelling units of families up to ₹ 1 lakh in rural and semi-urban areas and up to ₹ 2 lakh in urban and metropolitan areas.

The data retrieved from RBI's yearly trend and progress report (as plotted on *Graph1*and *Graph2* below) shows that the NPA ratio in agriculture was consistently higher than the other elements of the priority sector and is continuously increasing.

4.3 Graphs-Data retrieved from RBI



GRAPH 1 (data retrieved from:*www.**rbi**.org.in*)



GRAPH 2 (source: [data retrieved from:*www.**rbi**.org.in*])

It is imperative to find out the reasons for the higher ratio of NPAs in agriculture loans as well as the solutions for controlling them.

5. Reasons Contributing to High NPA Ratios in Agriculture Finance

1) **Challenges faced by agriculture sector:**

(i) Fragmentation and uneconomical size of land holdings- Fragmentation of land in India is widespread because of various reasons, such as the *Zamindari* system andthe division of land among family members overvarious generations, to name a few. It is believed thatthesefactors play an important role in explaining the low levels of agriculture productivity.83% of landholdings are held by small and marginal farmers, which in turn is leading to increasing NPAs.

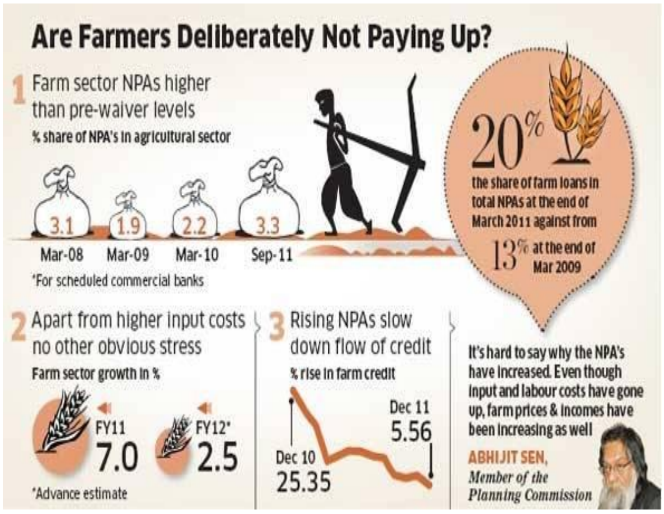
(ii) High wastage due to inadequate storage and supply chain infrastructure- Estimates indicate that roughly 7% of the total grain output, 10% of the seeds and between 25%to 40% of the fruits and vegetables get wasted every year.

(iii) Significant dependence on monsoon and inadequacy of irrigation facilities- Farming in India is still dependent on monsoons and traditional methods of agriculture. This leads to high risks and low productivity and in turn high NPAs.

(iv) Inadequacy of extension services in agriculture- Extension services include application of scientific research and new knowledge to agricultural practices through farmer education. It is on nascent stage in India leading to inadequate utilisation of resources.

2) **Government's Debt waiver schemes-**

The share of NPAsamongst the total agriculture loans extended by commercial banks is increasing by the day. Stress in the sector is insufficient to justify the rise in non-performing loans. According to the report of Standard and Chartered Securities, "*The problem with farm loans is not slow growth but rising non – performing loans as farmers expect more debt waive*₹" Abhijit Sen, member of planning commission carried out an analysis and added that "This is certainly no time for fresh waiver".



(source: [http://articles.economictimes.indiatimes.com/2013-01-23/news/36505468_1_net-bank-credit-priority-sector-loans-interest-subvention])

3) ***Mandatory requirements by the Government***

NPAs increased to Rs 302 billion as on March 2013, which can largely be attributed to existing policy prescriptions substantially increasing agricultural credit, such as mandatory agricultural credit target of 18% of adjusted net bank credit, fulfilling credit targets announced in the annual budget, targeting to disburse 20% to 25% more than the previous year through formulating a special agricultural credit plan, and aggressively marketing KCC. Besides, farmers were too incentivized through interest subvention for obtaining crop loans. This has led to inadequate inspection of documents and higher credit distribution and in turn higher volume of NPAs.

6. Suggestions and Discussions

The most important part of this paper is suggesting and discussing what actually should be done to reduce NPA's. Many of the suggestions below are already in practice though not widely but there is a need to revisit them to realise their importance.

1. *Financing Polyhouses*- Polyhouse farming is an alternative new technique in agriculture which is steadily gaining foothold in rural India.It reduces dependency on rainfall and makes the optimum use of land and water resources due to assured system. A typical, traditional farm of 4,000 square meters (1 acre) would generate an estimated annual income from ` 20,000 to `1,50,000 (depending upon type of cultivation i.e. cereals, vegetables and fruits) whereas estimated annual income from similar sized poly house is `1 lakh to `5 lakhs. Potentially, playhouse farming can help the farmer generate income around the year growing multiple crops and fetching premium pricing for off-season vegetables. This will solve the problem of dependence on monsoons and low productivity. Which in turn will reduce increasing cases of farmer suicides and increasing NPAs.So, targets should be set by the government for giving more and more loans for setting up polyhouse farming units.

2. *Agriclinics*-Agriclinics should be set up to provide expert services and advice to farmers on cropping practices, technology dissemination, crop protection from pests and diseases, market trends and prices of various crops in the market and also clinical services for animal health etc. which would enhance productivity of crops/animals. This will also educate the farmers and expose them to the developments in the agricultural sector and help them obtain fair prices for their produce in the market. This would effectively lead to poverty alleviation among the farmers which, in turn would encourage them to pay off their loans. One of the steps in the area is Kisan call centres–which has a toll free number and farmers can seek advice regarding farming techniques, methods etc. 24*7 free of cost.
3. *Less waivers more contributions*-Government's debt waivers should be less encouraged, and the monies used to fund the waivers should rather be channelized towards example-research and development to improve farming practices, educating the farmers, to name a few.
4. *Fair prices to farmers*- Market mechanisms should be built in a way so as to reduce the middlemen. Loans for building rural godowns should be sanctioned, and the government should take initiatives to build roads proper transportation system basically to discourage the middlemen from take undue advantage of these loopholes leading to unfair pricing of the crops of the farme`
5. *Documentation*- Banks should not sanction agriculture loans in haste to meet targets without proper diligence and documentation. Physical inspection of mortgages should be done and all the necessary documents, including the 'know-your-customer' documents should be obtained. Only after completing all the formalities should the banks sanction loans. Along with this, timely reviews should be carried outto ascertain whether the loan obtained for a certain purpose is being used for the same or not. In this regard, a separate team should be appointed in the rural areas. This would certainly help in reducing NPA level.
6. *Post-harvest finance*-Warehouse receipt financing and similar types of collateralized lending provide an alternative to traditional lending requirements of banks and other financiers and could provide opportunities to expand this lending in emerging economies for agricultural trade. The main contents include: (i) a description of warehouse receipt financing; (ii) details of the value of warehouse receipt financing; (iii) other collateral lending mechanisms; (iv) tradable receipt financing; and (v) the use of reverse factoring. The basic idea behind this method is securing loan against the underlying for which the loan is granted. This will both give security and certainty of the loans sanctioned. While this type of financing is in practice, it should be encouraged even further in orderto bring down the NPA levels.

7. Conclusion

Agriculture is the most important of contributors in our economy Despite such an overwhelming majority of the population being engaged in agricultural activities, it is very unfortunate that the agricultural credit system are yet not well developed in India and the existing systems are plagued with increasing number of NPAs. It is important to realise that this is a systemic problem which would not be fully solved by superflous means such as farm loan waivers, and has to be tackled by resorting to some modern techniques and sophisticated mechanisms, some of which have been highlighted in this paper. These techniques will not only help in reducing the number of NPAs, but also help increase production levels, reduce uncertainties and consequently, contribute to the overall growth of farmers in a sustainable manner.

Future Scope- Relevance of this topic for future research lies in examining the extent of the adaptation of suggested technologies and mechanisms. Further examining the impact of such adaptations on the NPA levels.

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