

पैतालीसवां वोल्यूम : नं. १ : जनवरी-जून, २००९ VOL. XXXV : No. 1 : JANUARY-JUNE, 2009

R. N. No. 15058/67

ISSN : 0004-3567

ARTHA - VIKAS अर्थ - विकास

JOURNAL OF ECONOMIC DEVELOPMENT

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RURAL AND AGRICULTURAL CREDIT IN INDIA AND GUJARAT - SOME ASPECTS

Dr. P.K. Singh and Dr. D.J. Chauhan

Rural and Agricultural Credit

Comprehensive Rural Credit Policy of India began with the publication of the Report of All India Rural Credit Survey Committee in 1954. The Report revealed that, in 1951-52, the share of institutional credit to rural households was only 7.3 per cent with the share of commercial banks lending being a merely 0.09 per cent. This reveals that the commercial banks and other financial institutions played an insignificant role in financing the farmers. However, banks became important instruments for rural finance with the nationalisation of 14 commercial banks in 1969. Later on, in 1980, six more banks were nationalized. In 1975 a major step of establishing regional rural banks (RRBs) was taken. The RRBs were set up in different states with equity participation from commercial banks, Central Government and state governments. For channelising the credit to rural areas the RBI had made various arrangements. For the consolidation of these efforts the NABARD was established in 1982.

RBI introduced "Service Area Approach" for commercial banks. This scheme was to concentrate on focused lending and contribute to development of the area. Next, the concept of Local Area Banks was taken up in 1996-97. Apart from the availability of credit lines from RBI the concept of "priority sector" was evolved as a policy measure to enhance the flow of credit to rural areas (Sehgal, 2007).

Policy Initiatives for Rural Banking

The Government has taken various policy initiatives to promote rural banking. These initiatives are: contributing additional capital to NABARD both by RBI and GOI, recapitalization and restructuring of RRBs, simplification of lending procedures as per Gupta Committee recommendations, preparation of special credit plans by public sector banks, launching of kisan credit cards to facilitate disbursement of crop loans and other short term loans, linking of SHGs with banks under NABARD scheme. RBI has also created Micro-finance Credit Development Fund for developing the microfinance (MF) sector. These initiatives have widened the network of rural financial institutions and have also helped in developing a banking culture and reservation of formal credit to rural area. Therefore, it has been helpful in providing adequate finances for the modernization of rural economies and implementation of anti-poverty and self employment programmes (Sehgal, 2007).

Dynamics of Rural Economy

Rural economy of India is showing signs of changes in form of greater integrations between rural

and urban areas and increased mobility in factor markets. Over the last few years agricultural sector is also showing greater degree of commercialization and diversification away from food grains production leading to increased need for purchased inputs. It has necessitated the need for loans, both for production and consumption purposes.

The RBI has also widened the scope of PS lending by including in it the "agri-clinics" and "agribusiness centres". Financing of purchase of land by marginal and small farmers has also been included in PS lending. The idea here is to accelerate the process of technology transfer and provide supplementary sources of input supply and services. To enable capacity generation new schemes like Capital Investment Subsidy Scheme, Food Parks covering rural godowns, Cold Storage Scheme, etc., have been introduced. Being profitable and viable, these schemes have opened new opportunities for financing. The Annual Report of RBI for 2002-03 has stated that.... "further increase in agricultural incomes will have to come from value-addition through agro-processing rather than agricultural production per se".

The rural lending operations of banks are also performing better now due to the improvement in the recovery of advances. The percentage of recovery of direct agricultural advances of public sector banks to demand has increased from 69.3 percent during 2001 to as much as 84.1 per cent in 2006.

The concept of micro finance is also gaining momentum. Micro credit institutions and SHGs are important for delivering credit to self employed persons as their operational costs are low and returns are better and assured.

Investment in Agriculture

Realising the importance of credit, as stated earlier, Government intends to continue with its efforts to turn the focus of commercial banks, RRBs and co-operative banks towards rural lending, especially production loans, to rural households and farm households.

Growth in agricultural production depends upon a number of factors, of which improvement in crop production technology in one. The technology and investment have, together, given the much needed food security and also improved the resilience of agricultural economy to a considerable extent. The orientation of agriculture is also changing from subsistence to market and from agriculture to 'agribusinesses'.

Against this background the Expert Group, 2005 (constituted by RBI on Investment Credit in Agriculture under the Chairmanship of Dr. Y.S.P. Thorat), examined the status, trends and composition of investment in agriculture (see Documentation: Report of the Expert Group on Investment Credit, Chairman: Y.S.P. Thorat, 2005). Investment in agriculture means acquiring physical assets that result in the creation of a stream of incremental income over a period of time for realizing long term potential.

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Long-term and medium term Credit are needed by the farm sector to meet the needs of investment. In addition, a large amount of short term credit is also required to meet production needs. Agricultural credit, thus, consists short, medium and long term credit. Farmers also need consumption credit to meet various requirements.

Agricultural credit in India has started to grow after nationalization and has been growing continuously since then. Over the years there has been a significant increase in the access of rural cultivators to institutional credit (see Table 1) and the role of informal agencies including money lenders as a source of credit has declined. According to the All India Rural Debt and Investment Survey 1991-92, the relative share of institutional agencies in the total cash debt of rural cultivators increased from 31.7 per cent in 1971 to 63.2 per cent in 1981 and further to 66.3 per cent in 1991. Nonetheless, recent years have again been characterized by a concern over the falling share of agricultural credit as a proportion of total credit (Mohan, 2004).

**Table 1: Total Direct Institutional Credit To Farm Sector
(Rs in crore)**

Period	Total direct institutional credit (Rs.)
1970-71	744
1980-81	3,438
1990-91	9,829
2001-02	41,385
2004-05	1,15,242

Source: 1. Handbook of Statistics in Indian Economy, 2002-03
2. Mohan, Rakesh, 2004, www.nabard.org

As is expected, the share of agricultural value added has been falling as a proportion of GDP. Consequently, the credit to agriculture is expected to decrease as a per cent of total credit, assuming relative stability in the share of purchased inputs as a proportion of value added. But the share of agricultural GDP has been continuously rising since 1950s and even a proportion of total GDP until the 1980s, and mid 1990s. After that it has not risen (see Table 2) (Mohan, 2004). However, the farm credit as a proportion of total credit has shown a continuous declining trend from a high of 10.8 per cent in seventies to a low of 5.5 percent in 2001-02.

The remarkable feature of agricultural credit extension in India is the widespread network of rural financing institutions (RFIs). Following the first phase of nationalization of commercial banks in 1969, large scale branch expansion was undertaken with a view to create a strong institutional base in rural areas. The mainstay in rural credit expansion in eighties and nineties has been the ascendancy of commercial banks along with RRBs, with a corresponding fall in the share of co-

operative societies (see Table 3). This is reflected in increasing concern in recent years over the effectiveness, governance and financial health of rural co-operative banks. Presently, just under half of the rural credit continues to be extended by co-operatives and hence it is essential that they be revitalized and put on a sound business footing (Mohan, 2004).

Table 2: Ratio of Direct Agricultural Credit to Agricultural GDP, Total GDP and Total Credit

Period	Agric. Credit to Agric. GDP	Agric. Credit to Total GDP	Agric. Credit to Total Credit*
1950-51	0.5	0.3	n.a
1960-61	3.3	1.3	n.a
1970's	5.4	2.1	10.8
1980's	8.3	2.6	8.5
1990's	7.4	2.0	6.4
2001-02	8.7	2.0	5.5

* Other bank credit to commercial sector has been taken as a proxy for total credit.

Source: 1. Report on Currency and Finance

2. Hand Book of Statistics on Indian Economy, 2002-03

3. Mohan, Rakesh, 2004

Table 3: Decadal Average Share of Institutional Credit in Direct Agricultural Disbursements (%)

Period	Cooperative Societies	RRBs	Commercial Banks
1970's	79.5	2.3	21.0
1980's	55.9	5.3	38.9
1990's	51.5	6.2	42.3
2001-02	44	11.00	45

Note: Direct agricultural credit (disbursements) from 1975-76 for RRBs and 1971-72 for commercial banks

Source: Handbook of Statistics on Indian Economy, 2002-03

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During post reforms period, there has been a significant reduction in the growth of institutional credit to agriculture. For instance during the period of 1981-91, the growth of institutional credit to agriculture was about 6.6 per cent but the same declined to 2.16 per cent during 1991 to 1999 (Mohan, 2004). The Government has been concerned with such a situation and has taken initiatives to increase the credit flow to agricultural sector and allied activities in the recent Union Budgets.

**Table 4: Flow of Agricultural Credit in Recent Years,
(Rs. In crore)**

Year	Flow of credit to agric. and allied activities	
	Targets	Credit flow
2004-05	105,000	125,300
2005-06	141,000	180,486
2006-07	175,000	*

* Target would be exceeded

Source: Union Budget, 2006-07

Beginning 2004-05, the Union Government has decided to double the flow of credit to farm sector in three years period. The target for credit flow to agriculture and allied activities for 2004-05 was Rs 1,05,000 crore but achievement was higher at Rs 1,25,309 crore. Similarly the credit flow during 2005-06 stood at Rs 1,80,486 crore while target was Rs 1,41,000 crore. For the year 2006-07, the target fixed was Rs 1,75,000 crore which would be exceeded (Anonymous, Economic Times, April 7, 2007).

Revised Priority Sector Lending Obligations

The RBI has expanded the base for calculating the level of directed lending with an aim to improve the funds availability to the PS. Under the new guidelines, the PS lending target and sub-target for all banks have been linked to Adjusted Net Bank Credit (ANBC). So far, a bank's exposure to the PS- agriculture, small scale industries, small business, micro -credit, educational loans and housing loans of upto Rs. 15 lakhs--was stipulated at minimum 40 per cent of its net credit. Thus, as per the guidelines, the total PS advances for domestic commercial banks would be 40 per cent of ANBC or credit equivalent of off--balance sheet exposures, whichever is higher while for foreign banks it is 32 per cent of which 18 per cent would be for total agricultural advances for domestic commercial banks.

In order to encourage banks to increasingly lend directly to the PS borrowers, the bank's deposits placed with NABARD/SIDBI on account of non-achievement of PS lending targets would also

not be eligible for classification as indirect finance to agriculture/small scale industries (SSI) in future. The advances to SSI would be included in computing performance under the overall PS target of 40 per cent to domestic commercial banks while for foreign banks it would be 10 per cent of ANBC. While export credit will not be a part of PS for domestic banks, foreign banks will have to target 12 percent of the sector. Advances to weaker sections and differential rate of interest (DRI) scheme will have the target of 10 per cent and 1 per cent, respectively, for domestic banks.

These guidelines also take into account the revised definition of small and micro enterprises as per the Micro, Small and Medium Enterprises Development Act, 2006. The definition of exposure to SSI, which will qualify for PS lending has also been revised to include "exposure to units engaged in the manufacture, processing or preservation of goods and whose investment in plant and machinery does not exceed Rs 5 crore will be considered as SSI against Rs. 1 crore hitherto". The micro credit included in PS has been defined as the "provision of credit and other financial services and products of very small amount not exceeding Rs 50,000 per borrower to the poor in rural, semi-urban and urban areas", either directly or through a group mechanism. This will boost the provision of credit and other financial services to the poor in rural, semi-urban and urban areas and facilitate the improvement in their living standards (Editorial, PNB Monthly Review, 2007).

Above guidelines is a step, in ensuring a 'Inclusive Financial Sector' by the regulator. Banks need to supplement credit while also providing the needed technical advisory services to ensure better productivity and income level for PS borrowers.

Performance of Rural Credit

In order to ascertain the improvement in rural credit delivery and the role of different agencies in meeting the credit needs, the share of institutional and non-institutional borrowings was examined for 1991-92 and 2002-03. The Unit Level Data of NSSO, Debt and Investment Survey, 48th and 59th Rounds revealed that at the All-India level, the share of non-institutional sources in rural credit declined marginally from 44.35 per cent in 1991-92 to 42.91 per cent in 2002-03, i.e. a decline of only 1.44 percent points. The share of institutional sources in the total rural credit increased slightly from 55.65 per cent in the former period to 57.09 per cent in the later period. For the state of Gujarat, the share of institutional sources showed only a 1.04 percent increase from 74.70 percent in 1991-92 to 75.74 percent in 2002-03. The share of non-institutional sources for the two periods was 25.30 percent and 24.26 percent respectively showing a very negligible decline in their share since the beginning of reforms process. During the period of baking reforms the emphasis of institutions has been on profitability; which, it seems, has eroded their mandate.

The attempt has also been made to study the growth in rural credit delivery. As the increase in disbursement of credit at the aggregate level, particularly in nominal terms, does not reveal the actual increase or decrease over a period of time. Therefore, borrowing per ha. and per capita

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in real terms at all India level and in Gujarat state were worked out. The borrowings by rural households per hectare of their cropped area as well as per capita were observed to have increased from both institutional and non-institutional sources. At the All-India level, the credit availability from institutional sources had increased from Rs.545/ha in 1991-92 to Rs1916 ha. In 2002-03, while per capita credit had increased from Rs 98 to Rs 254 during the period. Similarly, the borrowings from non-institutional sources had increased from Rs 435 per ha. in 1991-92 to Rs 1440 per ha. in 2002-03. while the per capita borrowings went up from Rs 79 to Rs 191. The per hectare and per capita borrowings from institutional sources between 1991-92 and 2002-03 have depicted an annual growth rate of 15 percent and 11 percent respectively, indicating that the institutional sources were increasing the credit availability to rural households significantly. But even this growth rate of institutional credit was not able to contain fully the growth of non-institutional financing which also grew at the rate of 14 percent per ha and 10 percent per capita basis annually.

The results for the Gujarat state were not different from that for the national averages. In the state, the per hectare borrowings of rural credit from institutional sources were Rs 582 during 1991-92 and Rs 1976 during 2002-03 depicting a compound annual growth rate of 14.4 percent. As against this, the borrowings from non-institutional sources went up from Rs 197 per ha. to Rs 633 per ha. during the two periods and grew at an annual compound rate of 13.7 percent. At the overall, the rural borrowings in Gujarat increased from Rs 780 to Rs 2608 per ha during the periods under consideration with the compound growth rate of 14.2 percent per annum. Likewise, the per capita borrowings, in the state, from institutional sources, went up from Rs 145 to Rs 384, showing a growth of 11.3 percent. During the two periods, the non-institutional borrowings increased from a low of Rs 49 per capita to Rs 123 per capita and depicted a growth of 10.6 percent per annum (Kumar, Singh and Kumar, 2007).

Rural Credit Support in Gujarat

Gujarat State has 53 commercial banks including 26 private sector banks, nine RRBs, one State co-operative bank, 18 district central co-operative banks and a State Co-operative Agriculture and Rural Development Bank. The total number of branches of all the banks were 5, 124. The average population per bank branch was 9,945. Total deposits with scheduled commercial banks were Rs 82,000 crore and advances were Rs 35,500 crore constituting credit: deposit ratio of 43.15. Dena Bank is the convener of State Level Banker's Committee. All the districts in the state were distributed between three commercial banks as Lead Banks. These were, State Bank of Saurashtra, Bank of Baroda and Dena Bank. NABARD takes active interest in pushing credit flow to agriculture and monitoring, apart from providing refinance. The flow of credit to agricultural and rural sectors was Rs 6,700 crore in 2003-04 which increased to Rs 8,700 crore in 2004-05, indicating an increase of 28 percent. For the year 2005-06 the expected credit flow was Rs 10,700 crore, an increase of about 28 percent. The Share of agriculture in the priority sector was 70.35 percent where as 73.6 percent of agricultural loan was crop loan. The effective interest rate was between 9 to 10 percent.

**Table 5: Sector -wise Disbursements during 2003-04 and 2004-05 in Gujarat State
(Rs in Lakhs)**

Sr. No.	Sector	Disbursements		Share (%)	
		2003-04	2004-05	2003-04	2004-05
1.	Agriculture and term banks	4,73,548	6,02,076	70.34	70.35
1.1	Crop Loans	3,69,678	4,43,214	54.91	51.05
2	Non-farm sector	90,444	1,02,140	13.43	11.76
3	Other priority sector	1,09,275	1,63,953	16.23	18.89
Total		6,73,267	8,68,169	100	100

Source: NABARD, Ahmedabad

Indebtedness

Recently published NSSO Survey, 2005 (59th Round about Indebtedness of Farmer Households) is relevant here. The Survey data pointed out that during 2003, there were 147.90 million rural households in the country of which around 89.35 million or roughly 60 per cent were cultivator households. Of these, 48.6 per cent households, translating into 43.4 million, were indebted to either formal sources or non-formal sources or both.

Against the 48.6 per cent indebted farmer households at national level the figure for Gujarat State at about 52 per cent was much higher (as shown in Table 6). Average amount of outstandings per indebted farmer was Rs 12,585 at the all India level and Rs 15,526 at Gujarat level. Major share of outstanding loans of their farmers has been contracted for capital and current expenditure in their farm business. At the all India level these heads accounted for 58.4 per cent of these loans (Sidhu and Gill, 2006). In Gujarat, farmers used over 70 per cent of such loans to meet the capital and current needs of their farm business. Non-productive loans in the State accounted for only 30 per cent of the total outstandings of which about 10 per cent were used for marriages, 6.3 per cent for consumption expenditure, 3 per cent on medical expenses and 5.6 per cent on other heads. Other minor expenditure items like non-farm business and education together accounted for 4.4 per cent of total outstanding loans.

Consequences of loans and their transformation into outstanding debt are influenced by sources of loans. Distribution of outstanding loans availed by farmers from different sources is shown in Table 3.6. At the all India level about 58 per cent of outstanding loans were from formal sources

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and remaining 42 per cent were obtained from various informal sources (mainly agricultural and professional moneylenders, traders, etc.) (Sidhu and Gill, 2004). In Gujarat State, the share of formal and informal loans was 69.5 per cent and 30.5 per cent respectively.

Co-operative Credit Structure in Gujarat

Co-operatives (coops) in Gujarat have played a very significant role in supporting and sustaining agricultural development in the State. Agricultural coops constitute about 45 per cent of total coops (about 56,146) in the State. The role of coops in agribusiness is to play a strong supportive role through creation of agricultural infrastructure, supply of agricultural inputs, making available the adequate and timely credit and marketing and processing of farm produce.

For short term agricultural credit the State has a three tier structure which is as follows:

Apex banks : The Gujarat State Co-operative Bank Limited, Ahmedabad.

Middle level banks: 17 districts central coop banks and 1 Kodinar Taluka Banking Union Ltd.

Grass root level: 8037 primary agricultural coop societies.

Farmer members: 41.52 lakh (provisional, 2000-01)

No. of farmers availing benefits of credit facility: 12.97 lakhs

For medium and long term credit the co. op. structure in Gujarat is as under:

Apex Bank: The Gujarat State Cooperative Agricultural and Rural Development Bank Limited, Ahmedabad.

Branches: 182 branches at taluka level.

Kisan credit cards: 19 lakhs.

Table 6: Percent of Indebted Households and Distribution of Outstanding Loans According to Purpose and Source During 2003

Particulars	Gujarat State	All India
1. Percentage of indebted farmer households (%)	51.9	48.6
2. Average outstanding amount per indebted farmer (Rs)	15,526	12,585
3. Purpose of Loan (%)		
a. Farm business	20.3	30.6
b. Non farm business	3.9	6.7
c. Consumption Expenditure	6.3	8.9
d. Marriage	10.1	11.1
e. Education	0.5	0.8
f. Medical	3.0	3.3
g. Other expenditure	5.6	10.8
Total	100	100
4. Sources of loans (%)		
a. Government	0.5	2.5
b. Cooperatives	41.8	19.6
c. Banks	27.2	35.6
d. Agric./professional moneylenders	6.5	25.7
e. Traders	4.4	5.2
f. Relatives, etc.	17.7	8.4
g. Doctor/Advocate, etc.	0.9	0.9
h. Others	10.0	2.1
Total	100	100

Figures in parenthesis are percentage to total

Source: NSSO (2005) and Directorate of Agriculture, Gujarat State

Delivery of Credit to Agriculture and other Segments of Priority Sector

Domestic scheduled commercial banks, both in the public and private sectors, are required to formulate special agricultural credit plans (SACP) in order to achieve a distinct improvement in the flow of credit to agriculture. During 2006-07 (by September end, 2007), disbursement to agriculture under SACP aggregated Rs 8,887 crore (public sector banks) and Rs 13,973 crore (provisional for private sector banks), respectively. Since the inception of kisan credit cards (KCC) scheme in 1998, the public sector banks have issued 25.6 million KCCs (upto December 2006) covering limits aggregating to Rs 88,279 crore. During 2006-07 (upto December 2006), 3.8 million KCCs were issued covering limits aggregating to Rs 19,781 crore.

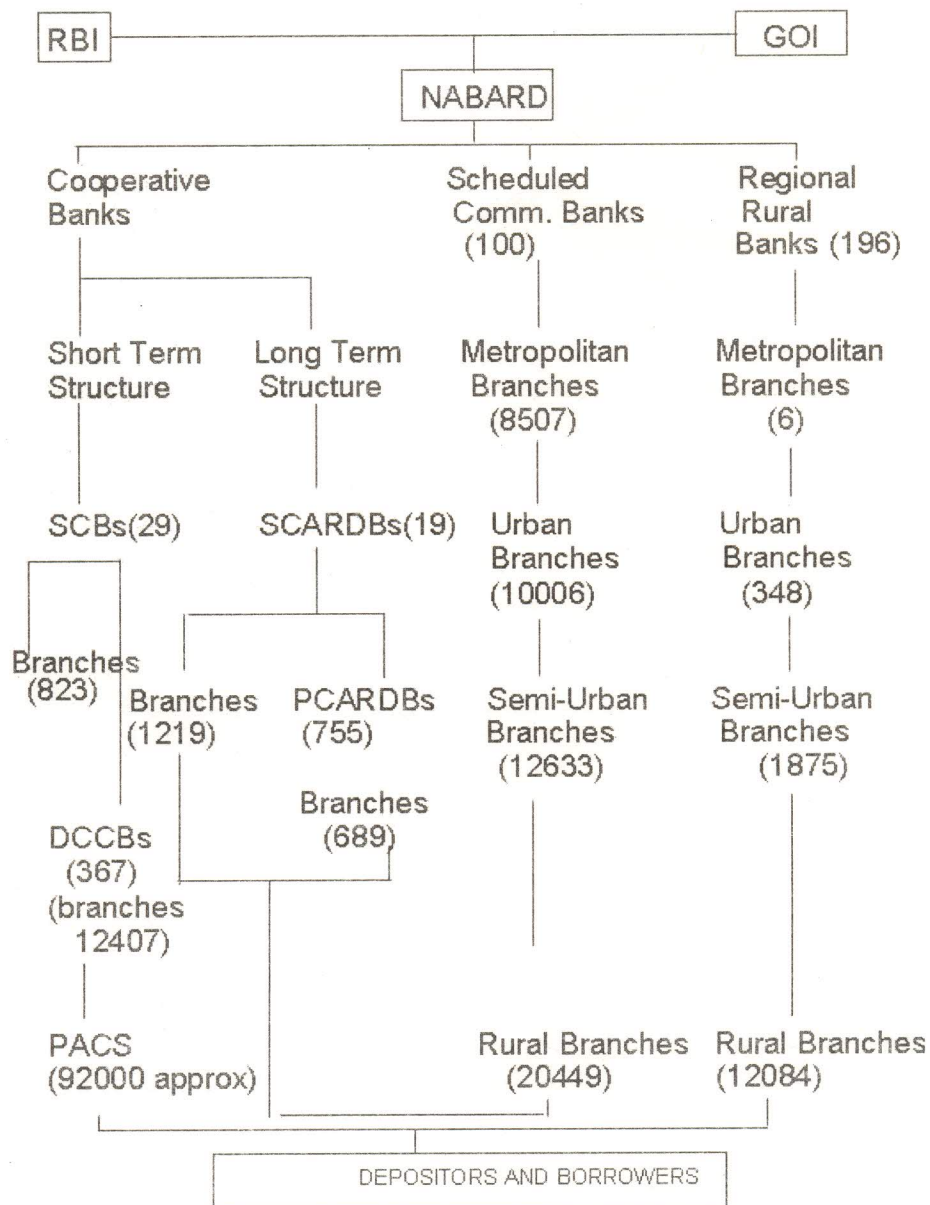
Institutional Structure of Agriculture and Rural Credit in India

Agricultural and rural credit system, as it has emerged in India, is shown in Chart-1. This system is a product of both evolution and intervention. It provides diversified type of credit for agriculture and rural sector. The country has followed a "supply -leading approach" to the institutional development for agriculture and rural credit which clearly started to grow after bank nationalization and has been growing continuously since then.

Institutional credit flow in Gujarat State

Aggregate institutional credit flow for agriculture in Gujarat State for the years 2003-04 through 2006-07 has been exhibited in Table 7 Total agricultural loans have two components namely, crop loans and term loans. In the State, the volume of aggregate institutional credit for agricultural sector has continuously increased from about Rs 4735 crore in 2003-04 to the projected amount of Rs 11,133 crore during 2006-07. In the aggregate loans the crop loans component has occupied the lion's share in different years. The share varied between 73 per cent in 2004-05 to 78 per cent in 2003-04. Remaining share being of term loans.

**Chart 1 : Institutional Structure -
Agriculture & Rural Credit in India**



Position as on 31 March 2001

Note: In addition to above agencies, Urban Cooperative Banks and Local Area Banks are also participating in purvey of credit for Agriculture and Rural Development.

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**Table 7: Aggregate Institutional Credit Flow to Agriculture in Gujarat
(Rs in Crores)**

Purpose	2003-04	2004-05	2005-06	Projections for 2006-07
Crop loans	3,696.78 (78.06)	4,432.14 (73.61)	5,933.50 (74.38)	8,602.26 (77.26)
Term loans	1,038.70 (21.94)	1,588.62 (26.39)	2,043.33 (25.62)	2,531.21 (22.74)
Total	4,735.48 (100)	6,020.76 (100)	7,976.83 (100)	11,133.47 (100)

Financial Inclusion and Microfinance

Nationalisation of banks in 1969 and subsequent developments led to expansion of the geographical and functional reach by commercial banks, RRBs and co-operative credit institutions. Public policy aimed at 'social' and 'development' banking by meeting rural credit needs and reducing the role of informal sector credit. It may be noted that despite the vast expansion, a large number of groups remain excluded from the opportunities and services provided by the financial sector. Such excluded groups include small and marginal farmers, women, unorganised sector workers including artisans, the self-employed and pensioners (Mahendra Dev, 2006).

Mr. P. Chidambaram, Union Finance Minister, in his Budget 2006-07 speech indicated that "out of the total number of cultivator households only 27 per cent received credit from formal sources and 22 per cent from informal sources".

The definition of financial inclusion (FI) may be given as the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. In the case of credit, the proper definition of the financially excluded would include house-holds who are denied credit in spite of their demand. Although credit is the most important component, FI covers various other financial services such as savings, insurance, payments and remittance facilities by the formal system to those who tend to be excluded (Mahendra Dev, 2006). Many households in the country are being exploited by moneylenders at exorbitant interest rates and, therefore, such households should not be seen as being financially excluded. FI, therefore, refers to households accessing institutional credit including commercial banks, co-operative banks, RRBs, NABARD SHG-linkage and other SHGs, and credible MFIs. It also refers to making more efforts towards covering small and marginal farmers and vulnerable social groups. A broader definition of inclusion should also focus not only on credit but also on increasing the productivity and sustainability of all vulnerable groups.

Self -Help Groups

RBI, in its Annual Policy Statement, 2005, recognized the problem of financial exclusion and initiated several policies for promoting the FI of self-employed and those employed in unorganised sector. Initiatives taken by NABARD have also contributed to FI. SHG- linkage programme of NABARD is such an initiative. The programme started in 1992 was initially a pilot programme.

There have been several institutional innovations in financial services following the success of Grameen Bank model of Bangladesh and SHG-bank linkage programme of NABARD. Many NGOs have taken to financial intermediation by creating their own innovative delivery approaches. Commercial banks and RRBs provide funds to MFIs for on- lending to their poor clients. Some MFIs are playing an important role by competing/substituting moneylenders. The competitive practices of several non-banking financial institutions in rural areas and SHG movement have helped in reducing interest rates in the informal credit market (Mahajan, 2004).

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