

Getting financial inclusion

With just 27% of farm households having access to formal credit sources, the problem is a serious one. But interest rate subsidies are not the solution

C RANGARAJAN

The banking sector has undergone far-reaching changes in the post-liberalisation period. The objective of banking reforms initiated in the recent period is to make the banking system both viable and efficient. Reforms initiated since early '90s have created an environment of increased competition leading to an improvement in customer services. Apart from policy changes of a fundamental nature, technology also played a key role in the transformation. It, however, needs to be pointed out that the reform measures introduced in the post-liberalisation period have in no way compromised with the goal of expanding credit to agricultural and other vulnerable groups.

It is true that banks have not fulfilled the stipulated requirement regarding the flow of credit to agriculture. But in this context, it is necessary to remember that the various prescriptions such as those relating to the flow of credit to agriculture as well as the total credit to the priority sector were introduced at a time when the pre-emptions in the form of Cash Reserve Ratio and Statutory Liquid Ratio were high. The period since 1991-92 has seen a fairly rapid expansion of credit to agriculture. Available data indicate that the flow of credit to agriculture by commercial banks and regional rural banks (RRBs) taken together increased from Rs 5,402 crore in 1991-92 to Rs 14,467 crore in 1996-97 and subsequently to Rs 60,022 crore in 2003-04. This implies a compound annual growth rate of 22.2 per cent.

Having said this, one must also recognise that the flow of credit from the organised financial system has bypassed the poorest sections. The NSSO survey of farmer households for 2003 show that 45.9 million farmer households in the country, that is, 51.4 per cent out of a total of 89.3 million households, do not access credit either from institutional or non-institutional sources. Further, only 27 per cent of the total farm households are indebted to formal sources; in other words, 73 per cent of farm households do not have access to formal credit sources. In the north-eastern, eastern and central regions only 19.6 per cent of the farm households are indebted to formal sources. Of the marginal farmer households, nearly 55 per cent do not have access to either formal or non-formal sources of credit. In contrast, in the case of large farmer households, the incidence of exclusions is 33.6 per cent.

I am confining my attention to commercial banks and RRBs. In one broad sense, I believe that we need to strengthen the existing institutional framework rather than create new institutions. There are, at present, 33,478 commercial bank branches in rural and semi-urban centres in the country. The critical question is how to make these rural branches more effective in terms of delivering credit to the small and the very small borrowers.

First, rural branches of banks have to be farmer-friendly. Lending to the low-income groups needs motivated bank staff. Such motivation is a function of attitude and beliefs as well as a system of incentives. Second, rural branches must go beyond providing credit and extend a helping hand in terms of advice on a wide variety of matters relating to agriculture. Third, in districts where

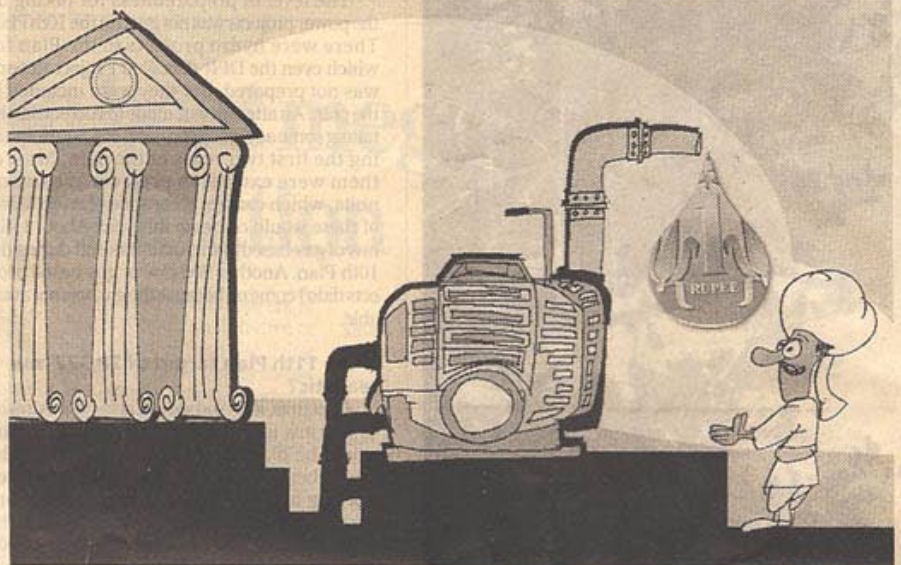


Illustration: ANIRBAN BORA

the population per branch is much higher than the national average, commercial banks may be encouraged to open branches. 139 districts in 15 states have been identified by the RBI as inadequately served by the banking system. Fourth, the SHG-bank linkage scheme has proved to be an effective way of providing credit to very small borrowers. This needs to be further strengthened. Fifth, the bank facilitator and correspondent model needs to be effectively implemented. However, one critical issue in the effective use of this model revolves around who should bear the additional transaction costs resulting from the employment of facilitators and correspondents. There has to be some flexibility with respect to the charging of interest rate. These transaction costs can still be accommodated within the present stipulation that the interest rate charged should not exceed the PLR.

The SHG-bank linkage program has worked well and has contributed significantly to financial inclusion. The cumulative number of groups financed by the banking system is close to 2.3 million. The financial inclusion attained through SHGs is sustainable and scalable on account of its various positive features. One of the distinctive features of the SHG-bank linkage programme has been the high recovery rate. However, the spread of SHGs is very uneven and is more concentrated in southern states. This regional imbalance needs to be corrected and special efforts in this regard may have to be taken by NABARD. However, there is no need to provide any interest rate subsidy to SHGs. Banks do provide them credit at reasonable rates of interest. The financial support of the state governments could be better directed towards building appropriate capacities in SHGs and providing technology support and marketing facilities.

With the changes introduced in the post-liberalisation period, there is a remarkable turnaround in the financial performance of the RRBs. They are yet another instrument to achieve the goal of financial inclusion. At present, RRBs have close

to 15,000 branches in rural areas. The share of RRBs in the loan account of all scheduled commercial banks in rural areas is an impressive 37 per cent. However, they account for only 21 per cent of the total credit outstanding in rural areas implying thereby that the clientele comprises of small borrowers. RRBs have done well also in relation to the promotion of SHGs. Of the total 22.4 lakh SHGs credit-linked by the banking industry, 33 per cent linkage is done by RRBs. The strengthening of the RRBs could be one major policy intervention for promoting greater financial inclusion. The operations of RRBs could be expanded to 80 hitherto uncovered districts.

Financial inclusion will undoubtedly result in additional costs, for instance, in extending the outreach to include small borrowers. While a part of it can be borne by the banks themselves, some part of it, particularly that relating to promotional efforts and building capacities, will have to be borne by the government. That is why the Committee on Financial Inclusion has recommended the setting up of two funds. This has been announced in the Budget for 2007-08.

However, creating an appropriate credit delivery system is only a necessary condition. This needs to be supplemented by efforts to improve the productivity of small and marginal farmers as well as other borrowers so that the credit made available can be productively employed. While banks and other financial institutions can take some efforts on their own to improve the absorptive capacity of the borrowers, it is equally important for the government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society. The two together can bring about the desired change of greater inclusion quickly.

The author is Chairman, Economic Advisory Council to the Prime Minister. This is a condensed version of the speech delivered at the Skoch Conference on Financial Inclusion on June 6 in Mumbai