IMPACT OF BANKING REFORMS ON RURAL DEVELOPMENT

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ABSTRACT

Since the days of nationalization, significant reforms have taken place in the area of rural development with the establishment of regional rural banks through banking sector reforms. The main thrust of banking reforms in the post nationalization era was essentially addressed to promote rural development through increased flow of credit to agriculture and other allied sectors in the rural areas. This has been done by establishing a large network of rural and semi urban branches followed by creation of RRBs. All these have contributed significantly to the enlarged flow of credit to rural areas. In fact this building up of institutional infrastructure has facilitated increased financial savings in the rural areas and simultaneously helped capital formation in agriculture and investment in other allied activates. This has cine into some sort of criticism not so much in terms of the basic objectives but in terms of mode of dispensation as well as the role of credit in the process of development. Rural credit structure devolved since nationalization has not only been directed but was also subsides in terms of interest cost.

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INTRODUCTION

The banking sector has witnessed a huge growth in the recent years. However, despite such a growth, the credit flow by banks to the rural and agricultural sectors remains dismal, which, more or less, has resulted in financial exclusion of the rural masses and the banks and the Chartered Accountants have a huge role to play in boosting the rural and agriculture sector through product innovation, broadening the reach, promotion of micro enterprises and providing know-how. The contribution of the banking and financial sector to the current economic growth of the Indian economy is very significant. This is reflected in the growth in aggregate deposits and advances for scheduled commercial banks, which stood at 19.83 per cent and 28.23per cent during 2011-2012. However, the access of banking services to the rural, agriculture and the common man in general is not as promising.

Rural banking was a neglected subject before nationalization of banks. Since the day of antinational significant reforms have taken place in the area of rural banking with the introduction of the lead bank scheme in India, establishment of regional rural banks and potential linked plans of NABARD etc. All these reforms both in terms of credit have evolved with a view to redress some specific problems that were being faced in the area of rural finance.

EVOLUTION OF THE FINANCIAL LANDSCAPE IN RURAL AREA

In Post-independence India, in order to facilitate improvements in agricultural production and attain food self-sufficiency, the stance of policy was to ensure sufficient and timely credit at "reasonable" rates of interest to as large a segment of the rural population as possible **(Rangarajan 1996).** The strategy to achieve this was threefold: expansion of the institutional base, directed lending to disadvantaged borrowers, and credit provision at concessional rates of interest. The latter was justified in terms of the perceived mismatch between the longer term returns of farm investment in relation to cultivator households' short term consumption needs and requirements to service the loans.

Fisher and Sriram (2006) identify three post-independence phases in rural credit provision. First, the 1950's up to the mid-1960's when cooperatives were the institutional vehicles of choice; second, the 1970's and 1980s when attention shifted to commercial banks and RRBs and third, the reform period in the early 1990's which saw the re-structuring of the banking system, the emergence of SHGs and a growing number of MFIs.

In terms of scale, spread, costs, risks, and the inter-temporal nature of credit markets, financial institutions and agents in India face formidable challenges in meeting the diverse financial service needs of the country's rural population. The present rural financial infrastructure comprises a wide variety of formal, semi-formal and informal financial service providers, with distinctive cultures and characteristics.

Different segments of the financial infrastructure have not developed uniformly or simultaneously, and their relative standing in terms of government policy and intervention has changed over time. Moreover, financial institutions have themselves influenced government policy (Jones 2006). In the following paragraphs, an attempt is made to trace the forces and compulsions that have led to the development of particular rural financial institutions in the country, to outline the changing fortunes and shares of these different systems, to show the present gap between rural financial needs and provisions, and to assess policy options to reduce this gap through institutional development, linkages and reform. In nutshell the impact of banking reforms on rural development is analyzed.

EVOLUTION OF COMMERCIAL BANKS IN RURAL AREA

The foundation for building a broad base of agricultural credit structure was laid by the report of the All-India Rural Credit Survey (AIRCS) of 1954. The provision of cultivator credit in 1951-52 was less than 1% for commercial banks. In the report it was observed that agricultural credit fell short of the right quantity, was not of the right type, did not fit the right purpose and often failed to go to the right people. As per the 2011 Census, over 70 per cent of the total Indian population resides in villages and rural areas. Rural development, thus, has become an integral part of development schemes and gained paramount significance in the Five Year Plans. Constant efforts are being made by the Central and State governments for upliftment of the rural society, as well as, to remodel and revolutionize the rural living standards across the country. Further, in order to bridge the gaps between rural and urban India, the Government has also invited the private sectors to participate in the nation building process for bringing about changes in the rural scenario. In India, rural development is an integrated effort to eliminate poverty, and sustain growth across all rural sectors. This includes setting up basic infrastructure and facilities such as medical facilities, schools, and transport facilities, apart from scheme implementation related to improving rural employment, agricultural productivity and rural industrialization.

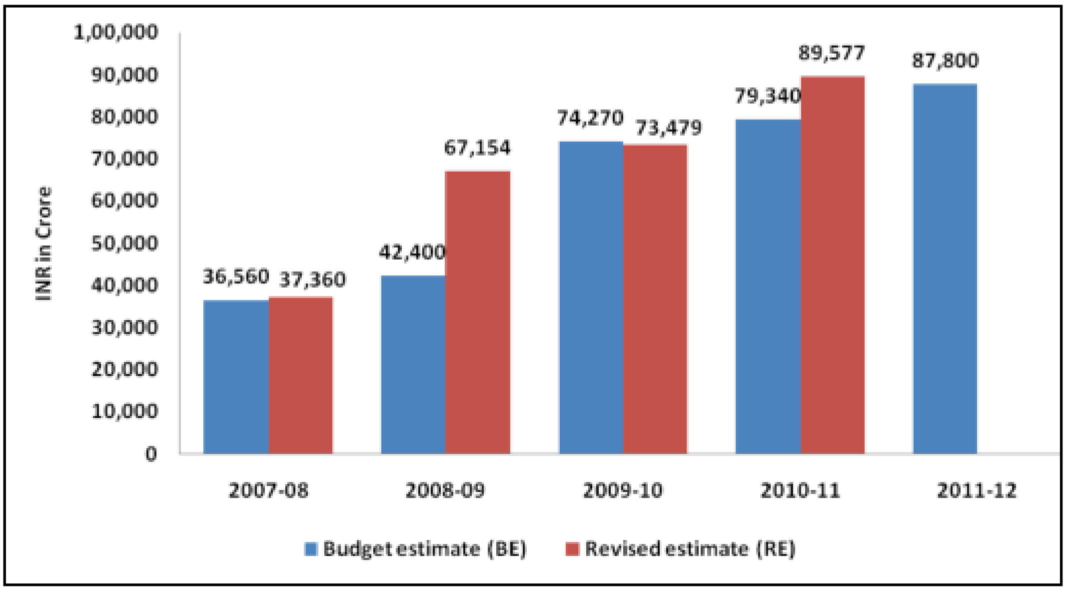

Fig.1: Outlays for Ministry of Rural Development during 11th Plan

Source: Ministry of Rural Development

The strong economic fundamentals based on an "all inclusive economic growth pattern" of the Indian economy and the Government's constant focus during the past six years on the rural economy has actually assisted in withholding the exceptional course of rural growth and development.

FINANCIAL SERVICES IN RURAL AREAS

Since the early 1980s, innovations in the delivery of financial services have enabled millions of people formerly excluded from the financial sector to gain access to these services on an ongoing basis. While there are overlaps in the financial sector among micro, rural and agricultural finance, it is important to understand how they differ and the various challenges they face:

- **Microfinance**. Financial services that focus on low-income households and small scale businesses in both rural and urban areas. Growing beyond micro credit, microfinance has blossomed since the early 2000s to include a range of financial services targeted to low-income clients, including savings, money transfer and insurance products.
- **Rural finance**. Financial services that focus on households and businesses in rural areas, encompassing both agricultural and non-agricultural activities, and targeting poor and non-poor women and men. Rural finance encompasses the full range of financial services that farmers and rural households require.

- **Agricultural finance**. Financial services that focus on on-farm activities and agricultural businesses, without necessarily targeting poor people. Fresh thinking has identified some of the key features of successful agricultural microfinance, replacing the heavily subsidized, unsustainable and unsuccessful approaches of the past.
- **Rural microfinance**. Financial services that focus on relatively small-scale products and services targeted to poor clients in rural areas. Given its focus on women, youth, indigenous peoples and poor people in rural areas, this is IFAD's main area of focus.
- **Financial service providers (FSPs).** Institutions and community groups that offer financial services, including commercial and development banks, non-bank financial institutions, cooperatives, savings and credit cooperative organizations (SACCOs), postal savings banks, self-help groups (SHGs), village savings and loan associations (VSLAs), financial service associations (FSAs), and even telecommunications providers (particularly in providing remittance services). Input suppliers, traders and agro processing companies can also provide financial services, such as credit for inputs and insurance to farmers through the value chain.

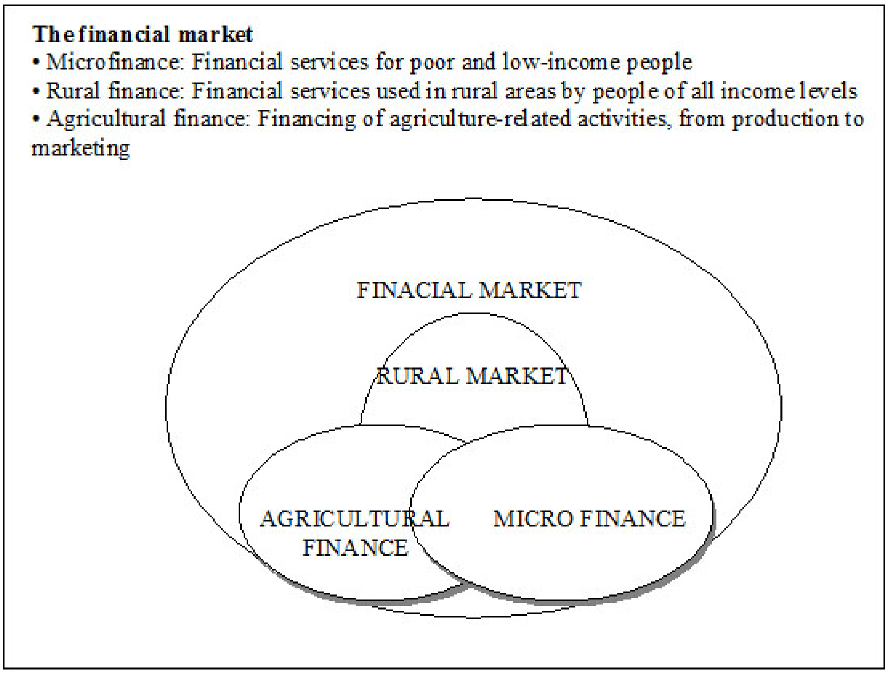

Fig.2: The Financial Market

Source: Adapted from CGAP (2009)

GROWTH OF BANKING REFORMS ON RURAL DEVELOPMENT

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 RRBs taken together increased to Rs. 863777 crore in 2011-12. This implies a compounded annual growth rate of 21.18%. In fact, as compared with commercial banks (including RRBs), the flow of credit from the cooperative sector was much slower through this period. The compounded annual growth rate of credit for agriculture from cooperative institutions was only 13.7%. Further, the proportion of agriculture credit to total credit came down because of the rapid growth in non agriculture credit. The Government took some major initiatives during the period to boost agriculture production and productivity through enhanced credit flow and by way of building agricultural infrastructure, particularly irrigation and connectivity in rural areas. Special Agricultural Credit Plan (SACP) was introduced by RBI for Public Sector Commercial Banks in 1994-95. Credit growth for agriculture and allied sectors under this caption reflected a CAGR of 38.24% during 2005-06 to 2010-11.

Special Agricultural Credit Plan (SACP) has since been extended to Private Sector Commercial Banks from 2010-11. The SHG – Bank Linkage Programme was started as a pilot project by NABARD in 1992. It led to the evolution of a set of RBI approved guidelines to banks to enable SHGs to transact with banks. Initially there was slow progress in the programme up to 1999 as only 32,995 groups were credit linked during the period 1992 to 1999. Since then the programme has been growing rapidly and the cumulative number of SHGs financed increased from 4.61 lakhs on 31 March 2002 to 10.73 lakhs on 31 March 2004 and further to 29.25 lakh groups as on 31 March 2007 ,41.24 lakhs groups as on 31 March 2012.

Rural Infrastructure Development Fund (RIDF) was set-up in NABARD by Government of India during 1995-96 with an initial corpus of Rs.2000 crore, to accelerate the completion of on-going projects of rural infrastructure. Banks which did not fulfill the priority sector credit requirement and agriculture credit mandate were required to contribute to this Fund. The fund has been strengthened every year with additional allocations in the Union Budget. A large number of irrigation and rural connectivity projects could get completed under Rural Infrastructure and Development Fund (RIDF). RBI scaled down its contribution to the Rural Credit funds with NABARD to a token amount of Rs.1 Crore per annum since 1993-94. However to enable NABARD to have reasonably strong leverage for accessing market funds, the share capital of NABARD was strengthened and increased to Rs.2000 crore (paid up) from Rs.100 Crore at the time of its formation in 1982. Contributions to enhanced share capital have come from GoI and RBI. By prudent funds management, the institution has also built a strong base of reserves and has been using it in its business operations judiciously to keep lending rates to rural financial institutions at significantly lower than market costs.

Table 1: Offices of Commercial Banks in India – 2005-2011

Bank Group	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**
State Bank of India and its Associates	14006	14294	14651	15814	16731	18186	18823
Nationalized Banks	35096	35848	37413	39204	40786	43467	45850
Foreign Banks	242	259	272	279	295	310	319
Regional Rural Banks	14763	14776	14812	15029	15384	15740	16034
Other Scheduled Commercial Banks	6462	6828	7415	8294	9186	9216	9436
Non- Scheduled Commercial Banks	37	41	46	46	46	48	53
Total	70606	72046	74609	78666	82408	86967	90515

Source:- Department of Statistics and Information Management, RBI.

The offices of commercial banks in India 2005-2011 are shown in table 1. The state banks of India and its associates were 14006 in 2005, but this increased to 18823 in 2011. But our main consideration in this thesis is rural development which reflects in the above table that regional rural banks were 14763 in 2005 but this increase to 14776 in the year 2006, 14812 in year 2007, 15029 in year 2008, 15384 in the year 2009, 15740 in the year 2010 and 16034 in the year 2011. This change in regional rural banks reflects upward trends since 2005 to 2011. It means the period of 2005-2011 reflects that there is a rural development in context of the banking sectors reforms in India.

CONCLUSION

The adoption of financial liberalization reforms has been a very laudable initiative given the extent of financial repression that was prevalent prior to these reforms and the stifling effects of repression on both the financial sector itself and on the economy as a whole. The rural population in India suffers from a great deal of indebtedness and is subject to exploitation in the credit market due to high interest rates and the lack of convenient access to credit. Rural households need credit for investing in agriculture and smoothening out seasonal fluctuations in earnings. Since cash flows and savings in rural areas for the majority of households are small, rural households typically tend to rely on credit for other consumption needs like education, food, housing, household functions, etc.

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