Quadrant II – Notes

Programme: B. Sc. (Hons.) Agri.

Subject: Agricultural Economics

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Course Title: Agricultural Finance and Cooperation

Module Name: Higher Financing Agencies - Reserve Bank of India (RBI) origin, objectives and functions, role of RBI in agricultural development and finance; National Bank for Agricultural and Rural Development (NABARD)-origin, functions, activities and its role in agricultural development; International Bank for Reconstruction and Development (IBRD); International Monetary Fund (IMF); International Development Agency (IDA); Asian Development Bank (ADB); Deposit Insurance and Credit Guarantee Corporation.

Module No: 12

Name of the Presenter: Dr. Rachana Kolambkar

Notes

Origin, functions and role of RBI in agricultural development and finance:

The Reserve Bank of India (RBI) was established in 1935 under the Reserve Bank of India Act, 1934. Its headquarters is located at Mumbai.

The RBI was set up to

- regulate the issue of bank notes
- secure monetary stability in the country
- operate currency and credit system to its advantage

The role of RBI in agricultural credit was found in the establishment of Agricultural Credit Department (ACD).

The primary functions of ACD are

- To coordinate the functions of RBI with other banks and state cooperative banks in respect of agricultural credit
- To maintain expert staff to study all the questions of agricultural credit and be available for consultation by central government, state governments, scheduled commercial banks and state cooperative banks.
- To provide legislations to check private money lending and checking other malpractices.

All India Rural Credit Survey Committee (AIRCSC) under the chairmanship of Sri. Gorwala in 1954 suggested several recommendations with regard to the activities of RBI in the sphere of rural credit. Based on this, two funds were established after amending RBI act, 1934.

1. National Agricultural credit (Long-term operations) fund-1955: It has started with an initial capital of Rs.10 crores and annual contribution of Rs.5 crore and later this was increased to Rs. 15 crores. This fund was meant to provide long–term loans to various state governments so as to enable them to contribute to the share capital of different types of cooperative societies including Land Mortgage Banks (LMBs). Loans and advances out of this fund are made to state governments for a period not exceeding 20 years.

2. National Agricultural credit (Stabilization fund)-1956: It was started with RBIs initial contribution of Rs. 1 crore and subsequent annual contribution of Rs. 1crore. This fund is utilized for the purpose of granting medium-term loans to State Co-operative Banks (SCBs), especially during the times of famines, droughts and other natural calamities when they are unable to repay their loans to RBI. The state and central cooperative banks and PACS in turn provide a similar

facility to the farmer - borrowers regarding short-term production loans taken for crops affected by the natural calamities. This helps the farmers in getting additional finance at the same time reducing their burden of repaying the loans immediately.

The functions of RBI in the sphere of rural credit can be dealt seen under three aspects:

1. Provision of finance

2. Promotional activities, and

3. Regulatory functions

Provision of Finance:

- Reserve Bank of India provides necessary finances needed by the farmers through the commercial banks, cooperative banks and RRBs on refinance basis.
- It advances long-term loans to state governments for their contribution to the share capital of the cooperative credit institutions like State Cooperative Banks (SCBs) and District Cooperative Central Banks (DCCBs).
- It advances medium-term loans to State Cooperative Banks.
- It extends refinance facility to the RRBs only to an extent of 50 per cent of outstanding advances.

Promotional activities:

Reserve Bank of India constitutes study teams to look into the organisation and operation of the cooperative credit institutions all over the country. It also conducts number of surveys and studies pertaining to rural credit aspects in the country. The RBI felt that the cooperatives are the major force in the field of agricultural credit and hence following measures were framed for the strengthening of cooperatives.

- Reorganisation of the state and central cooperative banks on the principle of one apex bank for each state and one central bank for each district.
- Rehabilitation of those central cooperative banks, which are financially weak due to mounting overdues, insufficiency of internal finances, untrained staff, poor management etc.
- Strengthening of PACS to ensure their financial and operational viability.
- Arranging suitable training programmes for the personnel of cooperative institutions.

Regulatory functions

- Reserve bank of India is concerned with efficiency of channels through which credit is distributed.
- Banking Regulation Act, 1966 makes the RBI to exercise effective supervision over cooperative banks and commercial banks.
- As per the Credit Authorized Scheme (CAS) of 1976, the cooperative banks should get prior authorization from RBI for providing finances beyond a certain limit.
- The cash liquidity ratio (CLR) and cash reserve ratio (CRR) are fixed by RBI for cooperatives, farmers service societies (FSS), regional rural banks (RRBs) and agricultural development banks (ADBs) at lower levels than those fixed for commercial banks. For these cooperative banks the bank rate was 3 per cent less than that of commercial banks. They are permitted by RBI to pay 0.5 per cent higher rate of interest on deposits.

Credit Control/ Credit Squeeze:

The term credit control or credit squeeze indicates the regulation by monetary authority i.e. RBI, on the volume and direction of credit advanced by the banking system, particularly the commercial banks. At times of inflation, credit control operations aim at contraction of credit, while during deflation they aim at expansion of credit. There are two methods of credit control

1. Quantitative or General Credit control: It aims at regulating the amount of bank advances i.e. to make banks to lend more or less.

2. Qualitative or Selective credit control: It aims at diverting the bank advances into certain channels or to discourage them from lending for certain purposes. These controls, in recent times assumed special significance, especially in under

developed economies. Credit Rationing: It is nothing but rationing of loans by non-price means at times of excess demand for credit. Under variable capital-asset ratio, the RBI fixes a ratio of capital to the total assets of the commercial banks. Origin of National Bank for Agricultural and Rural Development (NABARD): Agricultural Refinance and Development Corporation (ARDC) had not made an expected dent in the field of direct financing and delivery of rural credit against the massive credit demand for rural development. As a result, many committees and commissions were constituted like,

* Banking commission in 1972*National Commission on Agriculture (NCA) in 1976

* Committee to Review Arrangements for Institutional Credit in Agricultural and Rural Development (CRAFICARD) in 1979. This CRAFICARD, under the chairmanship of Sri. B. Sivaraman, a former member of planning commission recommended the setting up of a national level institution called NABARD for providing all types of production and investment credit for agriculture and rural development. As a result of CRAFICARD’S recommendations NABARD came into existence on July 12th, 1982. The then existing national level institutions such as Agricultural Refinance and Development Corporation (ARDC), Agricultural Credit Department (ACD) and Rural Planning and Credit Cell (RPCC) of RBI were merged with NABARD with a share capital of Rs.500 crore

equally contributed by Government of India and RBI. NABARD operates through its head office at Mumbai and 17 regional offices-one each in major states, 10 sub-offices in smaller states / U.Ts and 213 district offices.

Board of Management:

Central Government in consultation with RBI appoints all the directors in the "Board of Management "along with the chairman and the managing director (MD). The M.D. is the chief executive officer (C.E.O) of NABARD and he is primarily responsible for the various operations of the bank. Apart from M.D and Chairman, the Board of Management consists of 13 other directors and these directors will act as

"Advisory council" of NABARD. Of the 13 directors of Advisory council

- 2 are experts in rural economics and rural development.

- 3 are representatives of co- operatives

- 3 are representatives of commercial banks

- 3 are the officials of Government of India

- 2 officials belong to State Governments

Sources of funds:

Authorized share capital of NABARD is Rs. 500 crore equally contributed by Government of India and RBI and Issued and paid up capital of Rs. 100 crore. Other sources are:

- Borrowings from Government of India (GOI) and any institution approved by GOI
- Borrowings from RBI
- Deposits from state governments and local authorities
- Gifts and grants received.

Objectives:

- As an apex refinancing institution, NABARD survey and estimates all types of credit needed for the farm sector and rural development
- Taking responsibility of promoting and integrating rural development activities through refinance.
- With the approval of Government of India, NABARD also provides direct credit to any institution or organization or an individual.
- Maintaining close links with RBI for guidance and assistance in financial matters.
- Acting as an effective catalytic agent for rural development i.e in formulating appropriate rural development plans and policies.

Functions of NABARD:

The functions of NABARD are broadly categorized as

a) Credit activities

b) Development activities, and

c) Regulatory activities

a) Credit activities:

- NABARD prepares for each district a potential linked credit plan annually and this forms the basis for district credit plan.
- It participates in finalization of annual action plan at block, district and state level.
- It monitors the implementation of credit plans.
- It frames the terms and conditions to be followed by credit institutions in financing rural farm and non- farm sectors.
- It provides refinance facilities.

Refinance is of two types

1. Short-term refinance is extended for agricultural production operations and marketing of crops by farmers and farmers' cooperatives and production and marketing activities of village and cottage industries.

The eligible institutions for short term refinance are state cooperative banks (SCBs), regional rural banks, commercial banks and other banks approved by RBI. The time period is 12 months.

2. Medium term and long-term refinance is extended for investments in agriculture and allied activities such as minor irrigation, farm mechanization, dairy, horticulture and for investment activities of rural artisans, small scale industries (SSI) etc. The period is up to a maximum of 15 years. The eligible institutions are land development banks (LDBs).

The extent of refinance under various schemes is

- Pilot rainfed farming projects (100%) Wasteland development scheme of individuals (100%)
- Non-farm sector schemes (outside the purview of IRDP) 100%
- Agro-processing units (75%)
- Bio-gas scheme (75%)
- All other schemes including IRDP (70%)
- Farm mechanization (50%)
- Rural Electrification Corporation (50%)
- Apart from refinance, NABARD also provides direct finance to state governments, state sponsored corporations. NABARD will monitor its assisted projects in order to ensure their proper implementation. It also undertakes consultancy work for projects even though they are not refinanced by NABARD.

b) Development activities:

For the productive use of credit the following developmental activities are under taken by NABARD.

- Institutional development: Providing financial assistance for establishment and development of institutional financial agencies.
- Research and Development Fund: Providing funds for research and development efforts of institutional financial agencies.
- Agricultural and Rural Enterprises Incubation Fund (AREIF): For providing assistance while inception of new enterprises.
- Rural Promotion Corpus Fund (RPCF)

It is meant to provide financial assistance for training - cum production centers, rural entrepreneurship development programmes, and technical monitoring and evaluation centers.

Credit and Financial Services Fund (CFSF)

It aims at providing the assistance for innovations in rural banking and credit system, supports institutions for research activities, surveys, meets etc.

Linking SHGs to credit institutions: During the year 1992, NABARD started the pilot project of linking SHGs to credit institutions. Under this, it provides 100 per cent refinance to banks for loans extended to SHGs.

c) Regulatory activities

As an apex development bank, NABARD shares with RBI, some of the regulatory and supervisory functions in respect of cooperative banks and regional rural banks (RRBs). They are

- Under Banking regulation act 1949, NABARD undertakes the inspection of RRBs and cooperative banks (other than PACs)

- Any RRB or cooperative bank seeking permission of RBI, for opening branches needs recommendation of NABARD.
- The state and district central cooperative banks also need an authorization from NABARD for extending assistance to units outside the cooperative sector and non -credit cooperatives for certain purposes beyond the cut-off limit.

World Bank (WB):

The International Bank for Reconstruction and Development (IBRD) also called as World Bank was established in the year 1945 and started its operations in the year 1946. It is the sister institution of another international financial agency.

International Monetary Fund (IMF)

The IBRD/world bank's main aim is to reduce the poverty by promoting sustainable economic development in member countries. It attains this goal by providing loans and technical assistance for projects and programmes in its developing member countries.

The financial strength of IBRD is based on the support it receives from its shareholders and financial policies and practices adopted by it. The main activity of World Bank is to provide loans to the member- countries.

Functions of World Bank

Development activities:

It provides loans to its member-countries to meet their developmental needs. It also provides technical assistance and other services to the member countries to reduce poverty.

Providing Loans:

Each loan must be approved by IBRD's executive directors. Apart from providing loans it also waives the loans under special circumstances i.e. occurrence of natural calamities. After providing loans, the appraisal of the projects is carried out by IBRD's operational staff comprising engineers, financial analysts, economists and other specialists.

The loan disbursements are subjected to the fulfilment of conditions laid in the loan agreement. During the implementation, IBRD's experienced staff periodically visits the project site to review the progress and monitor whether the execution of project is in line with IBRD's policies. During these visits the bank staff help in resolving any problems that may arise during the execution of the project. After the completion, the projects are evaluated by an independent body

and findings will be reported to the executive directors to determine the extent to which project objectives were fulfilled.

Consultancy:

In addition to the financial help, IBRD also provides technical assistance to its member countries irrespective of loans taken from it or not. There is a growing demand from borrowers for strategic advise, knowledge transfer and capacity building.

Research and Training:

For assisting its member countries, the World Bank offers courses and training related to economic policy development and administration for governments and organizations that work closely with IBRD.

Trust–Fund Administration:

IBRD itself or jointly with International Development Agency (IDA), on behalf of donors restricts the use of funds for specific purposes only. The funds so obtained are not included in the list of assets owned by IBRD.

Investment Management:

IBRD provides investment management services for external institutions by charging a fee. The funds thus obtained are not included in the assets of IBRD.

Affiliated Organizations of IBRD:

To complement the activities of IBRD, there are three affiliated organizations and they are

1. International Development Association (IDA):

It was established in the year 1960. Its main goal is to reduce the poverty through promoting economic development in less developed areas of the world. The International Bank for Reconstruction and Development (IBRD), better known as the World Bank, was established in 1944 to help Europe recover from the devastation of World War II. The success of that enterprise led the bank, within a few years, to turn its attention to developing countries. By the 1950s, it became clear that the poorest developing countries needed softer terms than those that could be offered by the bank, so they could afford to borrow the capital they needed to grow. With the United States taking the initiative, a group of the bank's member countries decided to set up an agency that could lend to the poorest countries on the most favourable terms possible. They called the agency the "International Development Association." Its founders saw IDA as a way for the "haves" of the world to help the "have-nots." But they also wanted IDA to be run with the discipline of a bank. For this reason, US President

Dwight D. Eisenhower proposed, and other countries agreed, that IDA should be part of the World Bank.

IDA's Articles of Agreement became effective in 1960. The first IDA loans, known as credits, were approved in 1961 to Chile, Honduras, India and Sudan. IDA currently has 169 member countries. Members subscribe to IDA's initial subscriptions and subsequent replenishments by submitting the necessary documentation and making the required payments under the replenishment arrangements. The International Development Association (IDA) is the part of the World Bank that helps the world's poorest countries. Established in 1960, IDA aims to reduce poverty by providing interest-free credit and grants for programmes that boost economic growth, reduce inequalities and improve people's living conditions. IDA complements the World Bank's other lending arm–the International Bank for

Reconstruction and Development (IBRD)–which serves middle-income countries with capital investment and advisory services. IBRD and IDA share the same staff and headquarters and evaluate projects with the same rigorous standards.

IDA is one of the largest sources of assistance for the world's 79 poorest countries, 39 of which are in Africa. It is the single largest source of donor funds for basic social services in the poorest countries.

IDA lends money (known as credits) on concessional terms. This means that IDA credits have no interest charge and repayments are stretched over 35 to 40 years, including a 10-year grace period. IDA also provides grants to countries at risk of debt distress. Since its inception, IDA credits and grants have totaled US$207 billion, averaging US$14 billion a year in recent years and directing the largest share, about 50 percent, to Africa.

2. International Financial Corporation (IFC):

It was established in the year 1955.Its main aim is to encourage the growth of productive private enterprises in the member- countries by providing loans and

investments without a member's guarantee.

3. Multilateral Investment Guarantee Agency (MIGA):

Its main aim is to encourage the flow of investments for productive purposes among member countries particularly in developing countries. IBRD, IDA, IFC and MIGA are collectively called as World Bank Group. Each of them is financially independent, with separate assets and liabilities.

International Monetary Fund (IMF):

The International Monetary Fund (IMF) is an international organization. At present 185 countries are the members of IMF. Its headquarters is located at Washington, DC., USA. Origin: After the Second World War, many countries felt the need to have an organization to get help in monetary matters between countries. To begin with, 29 countries discussed the matter, and signed an agreement. The agreement was the Articles of Association of the International Monetary Fund. IMF came in to being in December 1945.

Membership: Any country can apply to become a member of the IMF. When a country applies for membership, the IMF's Executive Board examines the application. If found suitable, the Executive Board gives its report to IMF's Board of Governors. After the Board of Governors clears the application, the country may join the IMF. However,

before joining, the country should fulfil legal requirements, if any, of its own country. Every member has a different voting right. Likewise, every country has a different right to draw funds. This depends on many factors, including the member country's first subscription to the IMF.

Functions:

The IMF does a number of supervisory works relating to financial dealings between different countries. Some of the works done by IMF are:

- Helping in international trade, that is, business between countries

- Looking after exchange rates
- Looking after balance of payments
- Helping member countries in economic development

Management

A Board of Directors manages the IMF. One tradition has governed the selection of two most senior posts of IMF. Firstly, IMF’s managing director is always European. IMF’s president is always from the United States of America. The major countries of Europe and America control the IMF. This is because they have given more money to IMF by way of first subscriptions, and so have larger share of voting rights.

Asian Development Bank (ADB):

The Asian Development Bank is a regional development bank established in the year 1966 to promote economic and social development in Asia and Pacific countries by providing loans and technical assistance. The ADB’s headquarters are located at Manila, Philippines. It aims at eradication of poverty in the Asia – Pacific region. It is a multilateral financial institution owned by 67 members, with 48 members from the region of Asia- pacific and 19 from other parts of globe. The highest policy making body of the bank is the Board of Governors consists of one representative from each member country. The Board of Governors, in turn, elect among themselves, the 12-member Board of Directors. Eight of the twelve members come from Asia- Pacific members, while the rest come from non-regional members.

The Board of Governors also elects the bank’s president who is the chairperson

of the Board of Directors and manages the ADB. The term of office of president lasts for five years, and may be re-elected for second term. As Japan is the largest shareholder of the bank, traditionally the president has always been from Japan.

The ADB was founded in 1966 with goal of eradicating the poverty in the Asia-Pacific region. With over 1.9 billion people living on less than $2 a day in Asia, the institution has a formidable challenge. It plays the following functions for countries in the

Asia –Pacific region:

- Provides loans and equity investments to its developing member countries (DMCs).
- Provides technical assistance for the planning and execution of development projects, programmes and for advisory services.
- Promotes and facilitates investment of public and provide capital for development.
- Assists in coordinating developmental policies and plans of its DMCs.

Deposit Insurance and Credit Guarantee Corporation (DICGC):

The concept of insuring deposits kept with banks received attention for the first time in the year 1948 after the banking crisis in Bengal. The question came up for reconsideration in the year 1949, but it was decided to hold it in abeyance till the Reserve Bank of India ensured adequate arrangements for inspection of banks. Subsequently, in the year 1950, the Rural Banking Enquiry Committee also supported the concept. Serious thought to the concept was, however, given by the Reserve Bank of India and the Central Government after the crash of the Palai Central Bank Ltd., and the Laxmi Bank Ltd. in 1960. The Deposit Insurance Corporation (DIC) Bill was introduced in the Parliament on August 21, 1961. After it was passed by the Parliament, the Bill got the assent of the President on December 7, 1961 and the Deposit Insurance Act, 1961 came into force on January 1, 1962. The Deposit Insurance Scheme was initially extended to functioning commercial banks only. This included the State Bank of India and its subsidiaries, other commercial banks and the branches of the foreign banks operating in India. Since 1968, with the enactment of the Deposit Insurance Corporation (Amendment) Act, 1968, the Corporation was required to register the 'eligible co-operative banks' as insured banks under the provisions of Section 13 A of the Act. An eligible co-operative bank means a co-operative bank (whether it is a state co-operative bank, a central co-operative bank or a primary co-operative bank) in a state which has passed the enabling legislation amending its Co-operative Societies Act, requiring the State Government to vest power in the Reserve Bank to order the Registrar of Co-operative Societies of a state to wind up a co-operative bank or to supersede its committee of management and to require the registrar not to take any action for winding up, amalgamation or reconstruction of a co-operative bank without prior sanction in writing from the Reserve Bank of India. Further, the Government of India, in consultation with the Reserve Bank of India, introduced a Credit Guarantee Scheme in July 1960. The Reserve Bank of India was entrusted with the administration of the scheme, as an agent of the Central Government, under Section 17 (11 A)(a) of the Reserve Bank of India Act, 1934 and was designated as the Credit Guarantee Organization (CGO) for guaranteeing the advances granted by banks and other credit institutions to small scale industries. The Reserve Bank of India operated the scheme up to March 31, 1981.

The Reserve Bank of India also promoted a public limited company on January 14, 1971, named the Credit Guarantee Corporation of India Ltd. (CGCI). The main thrust of the Credit Guarantee Schemes, introduced by the Credit Guarantee Corporation of India Ltd., was aimed at encouraging the commercial banks to cater to the credit needs of the hitherto neglected sectors, particularly the weaker sections of the society engaged in non-industrial activities, by providing guarantee cover to the loans and advances granted by the credit institutions to small and needy borrowers covered under the priority sector with a view to integrating the functions of deposit insurance and credit guarantee, the above two organizations (DIC and CGCI) were merged and the present Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence on July 15, 1978. Consequently, the title of Deposit Insurance Act, 1961 was changed to 'The Deposit Insurance and Credit Guarantee Corporation Act, 1961. Effective from April 1, 1981, the corporation extended its guarantee support to credit granted to small scale industries also, after the cancellation of the Government of India's credit guarantee scheme. With effect from April 1, 1989, guarantee cover was extended to the entire priority sector advances, as per the definition of the Reserve Bank of India. However, effective from April 1, 1995, all housing loans have been excluded from the purview of guarantee cover by the corporation.

Objective of DICGC:

To contribute to stability and public confidence in the banking system through provision of deposit insurance and credit guarantee to small depositors and borrowers :