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*While focusing on inflation, it is also important to remember that agriculture, growing at just 2-3 per cent, needs cheap credit to meet working capital and to move to a higher level of technology. The priority sector system still plays a useful role, says SHASHANKA BHIDE.*

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Agriculture can hardly be insulated from the effects of macroeconomic policies. If not immediately, policy changes may affect agriculture with a lag. The growth of bank credit to the agriculture component of the priority sector had slowed in 2008-09, compared with the high rates seen in the final years of the Tenth Five Year Plan. Similarly, there was slowing down in the growth of total non-food credit.

The global financial crisis dampened the growth of credit to non-agricultural sectors more than to agriculture. Lower interest rates --- when the monetary policy transmission mechanism works --- would also mean lower rates for farm credit, or vice versa. Monetary policy, which targets or manages parameters such as inflation and exchange rate, has an impact on agriculture through its impact on agricultural investments, exports and imports.

A moderate rate of inflation is also good for the farm sector, although steady changes

in relative prices in its favour may have some beneficial impact on farm investment.

### PRIORITY SECTOR LENDING

For all the resilience and promise of the sector, a protective environment for farm credit through the priority sector lending framework is still important. These policies ensure that bank credit, or more appropriately institutional credit to agriculture, does not get crowded out by the other sectors.

The monetary policy for the current financial year focuses on protecting growth recovery and reducing inflation. With agricultural commodities as the main culprits of the inflationary phase of the past year, monetary policy can only try and limit the spillover of these impulses to the rest of the economy. Apart from measures to restrain liquidity, the monetary policy statement for the current financial year takes note of the progress made with respect to the strengthening of farm credit cooperatives, better credit supply planning and farm credit in general.

It also outlines steps to ensure that bank presence in some form in every village becomes reality. Judging by these measures, growth of agricultural credit appears to be supply-driven rather than demand-driven. Further, a lot of priority sector credit ends up as indirect credit rather than direct credit to the farmers.

### THE TECHNOLOGY FACTOR

Farm loans attract periodic attention for the loan waiver schemes, rather than the crucial role they play in modernising farm operations. Buying a tractor, pumpset, or merely paying for fertiliser before the harvest brings in revenues has become increasingly possible because there is credit supply. It is often noted that more than half the cultivator households are indebted -- which is not surprising, given the lumpy nature of income flows.

Working capital loans are most sustainable from the farmer's viewpoint because they are directly linked to the revenue from the current crop season. Long-term credit is linked to income growth, and unless significant income growth is realised debt repayment becomes a problem. Long-term credit has to be increasingly technology-related, so that it alters the income stream of the farms. Without this link, credit can only have a gradual impact through stabilising income.

### CHEAP CREDIT NECESSARY

Should farm credit supply be on commercial terms? A limiting factor in pushing credit is the fact that land is the main collateral and the only asset that farmers possess for a livelihood. However, the fact that more aggressive targets for institutional credit have been achieved in the recent past is a significant policy accomplishment. Was this achieved by expanding the basket of enterprises eligible as farm loans? Or was it achieved by moving into areas where bank presence was weak? Farm credit accounts

for less than 15 per cent of the total non-food credit of scheduled commercial banks.

However, it is still sizable. With this significant share farm credit should be an attractive part of portfolio of the banking sector's assets. Even so, priority sector compulsions are still necessary to ensure that banks continue to lend to the sector, directly or indirectly.

Aggressive lending makes sense if credit leads to income growth for the borrower. At a given level of technology, the cost of credit clearly has an impact on the level of demand for credit. With barely 2-3 per cent growth in farm output, the farm sector would not be able to borrow at higher rates.

Farm credit is supposed to be cheaper than other loans. Yet, it is still priced at about 8-9 per cent. Subventions on interest rate are needed to keep interest payments viable for the farm sector, unless there is faster agricultural output growth. Monetary policy aiming to protect growth momentum is equally important for the farm sector.

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