Policy brief
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Evaluating the Kisan Credit Scheme

Results from Bihar and India

In brief

- The Government of India introduced the Kisan Credit Card (KCC) scheme in its 1998-99 budget to provide timely, short-term agricultural credit to farmers through the banks under a single window system. By March 2011, more than 100 million KCC accounts had been issued nationwide.
- This brief outlines results from a study examining the impact of the KCC Scheme on economic growth and agricultural productivity at the state and district level from 2005-06 to 2009-10. The analysis included all districts in Bihar.
- The findings show the KCC scheme had no impact on agricultural credit and economic growth both at the state and district level. However, states with better access to credit initially had greater amount of KCC lending subsequently. Commercial banks were found to be the largest source of credit under the KCC scheme at the state level.
- While Bihar shows higher adoption rates for KCC lending than other states, issues like multiple account holdings, chances of high default rates due to low interest rates, and lack of collateral are risks for banks.
- Proper regulation could make the KCC scheme more effective through initiatives like linking accounts with the Aadhaar card to reduce multiple accounts and digitising land records. Banks should also capture accurate information on land ownership, irrigation, types of crops, and cropping patterns before providing loans under this scheme.
- Further research is needed to understand whether this scheme has actually reduced transaction costs for banks and their default rates.

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Motivation

Access to credit and the role of financial intermediation in agriculture has always been the centrepiece of policymaking in India. In order to meet farmers' credit requirements in a timely and hassle-free manner, the Kisan Credit Card scheme (KCC) was introduced by the Government of India in its 1998-99 budget. The earlier system was characterised by a "multiple-product, multiple agency system" in which farmers had to make multiple loan applications for different stages and needs in the farming process (Samantara, 2010). This scheme sought to consolidate the system of agricultural credit for farmers.

By 2004, the Reserve Bank of India (RBI), apart from providing traditional crop loans under this scheme, also provided consumption credit for farmers. This scheme centres on a revolving credit line facility with three user-friendly features: no collateral requirements, less stringent monitoring of actual loan use, and easy renewal after three years for borrowers in good standing. By March 2011, more than 100 million KCC accounts had been issued. Given the dominant role of this scheme in providing agriculture credit, an evaluation study was needed to measure its performance.

Three major survey-based studies had already been conducted on the progress of the KCC scheme. The Planning Commission study (2000) showed the landholding ratio achieved under this scheme was 30 percent in Andhra Pradesh and a little more than 1 percent in Bihar. The other two studies were conducted by the National Council of Applied Economic Research (NCAER) (2005) and National Bank for Agriculture and Rural Development (NABARD) (2010) – both studies excluded Bihar and included many other states. While all three surveys are excellent sources of information on the success and failures of the scheme at a micro-level, none of these studies showed the impact of this scheme on agricultural productivity and economic growth in India.

There is an extensive literature on the effect of financial development on agricultural and rural growth in Indian context, which found: a branch expansion programme in 1977 led to increased access to banking in rural areas and increased output (Burgess and Pande, 2005; Guha, 2009); nationalisation of private banks in 1980 led to an increase in credit in priority sectors of the economy (Cole, 2009) and an increase in agricultural credit post-liberalisation (Ramakumar and Chavan, 2007). The Ramakumar and Chavan (2007) study also showed that from 2004-05 to 2009-10, the increase in agricultural credit during this period is not just because of the KCC scheme but also because of other credit initiatives like the bank credit linkage programme given to Self-Help Groups (SHGs) and the Rural Infrastructure Development Fund (RIDF) initiative. However, the scale of the KCC scheme was much larger than both these other schemes.

The study

The aim of this study was to examine the impact of the KCC scheme on economic growth and agricultural productivity. At the state level, this paper examines the determinants of KCC adoption rates across states and their effects on agricultural productivity, food grains yields, and per capita income. This helps in understanding the inter-state effects of the KCC scheme and the achievement of Bihar relative to other states. At the district level, the focus is on all 38 districts of Bihar. However, due to data limitations, the focus was more on examining the impact on agricultural productivity.

Data and methodology

For state level analysis, the time period used is 2005-06 to 2009-10 using data on KCC credit from RBI's annual Trends and Progress of Banking in India and various secondary sources for other indicators.

For district level analysis, data on KCC was taken from the State Level Banking Committee (SLBC)1 reports from various years. However, in 2004, all crop loans were being routed through KCC as per RBI. Therefore, crop loan value from 2005 onwards was used as a measure for KCC credit for the district level.

At the state level, three specific questions were studied:

1. What are the determinants of growth in KCC lending over the period 2005-09?
2. Did Bihar do better or worse during this period relative to other states? ("Bihar" effect)
3. Did higher KCC lending lead to higher growth rates of overall state GDP per capita, agriculture GDP per capita worker, and foodgrain yield?

Questions 1 and 3 were also studied at the district level.

Research findings

Findings show that Bihar made significant progress in KCC lending, and by 2009, was among the top three Indian states in terms of KCC credit relative to agricultural state domestic product. As far as sources for KCC credit, commercial banks were the largest lender at the state level, but regional rural banks played a significant role as well. On the determinants of KCC lending, the relative size of the agriculture sector and the extent of agricultural credit is important at the state level. The results also show that though Bihar performed relatively well in KCC lending, other BIMARU states did even better. As far as growth effects, KCC lending had no impact

1. SLBC is an apex bank committee in each state.

on Gross State Domestic Product (GSDP) growth rates. Even interacting KCC lending with initial agricultural productivity had no impact on GSDP growth rates.

At the district level for Bihar, results show that KCC lending has no effect on agricultural productivity. Also, inequalities in the amount of KCC lending have increased across all districts in Bihar, in which Munger experienced a sizeable decline from 10 percent to 6 percent, while districts like Jehanabad and Saharsa improved from around 30 percent to 32 percent.

The findings from this study suggest that Indian states with greater access to agricultural credit had a greater amount of KCC lending during the 2005-09 period. Also, for Bihar and other BIMARU states, where KCC lending has been increasing over these periods, this increase in lending is not due to economic growth. This can help policymakers understand that the high adoption rates under this scheme does not reflect Bihar's relative economic backwardness.

In Bihar, districts with greater lending in KCC initially continue to pull further away from other districts, while in terms of account holders, there is high inequality across districts. This shows that the KCC scheme has received adequate support relative to the overall development strategies being pursued in the state.

Conclusion

The KCC scheme has been in effect now for around two decades. It was launched by NABARD and RBI with an aim to reduce farmers' dependency on informal credit and provide credit primarily related to crop production in a timely manner. This rural credit scheme has increasingly become a source of investment and consumption for farmers. However, this study showed that at the state level, there is very little relationship between KCC lending and agricultural productivity. At the district level for Bihar, the only strong predictor for KCC lending is initial levels of KCC lending.

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Based on some of the discussions with bank and government officials in Bihar, this study highlights the blame game between the state government of Bihar and commercial banks as a major issue. The state government often criticises the commercial banks for not supporting the provision of KCC credit, whereas commercial banks always fear default due to the nature of KCC credit, believing that borrowers quite often evade paying back their loans. The other challenge is multiple accounts held by the same borrower in different banks, and with land records not been digitised, a lender can easily bribe a loan official and claim multiple loans for the same piece of land. It is also easy to provide counterfeit documents especially with government-organised mass enrolment under the KCC scheme. The next section outlines some policy recommendations based on the research findings.

Policy recommendations and future research questions

- **Agricultural credit should be long-term:** Under the KCC scheme, crop loans should be given for longer terms. Long-term credit will help policymakers understand the impact of KCC on economic growth and agricultural productivity and the effectiveness of the scheme over time.
- **Banks should capture accurate information:** Commercial and regional rural banks should capture more accurate information on crop production such as land owned by the borrower, whether that land is irrigated, types of crops, and cropping patterns.
- **KCC accounts should be linked with Aadhaar:** This may help in eliminating duplicate account holders as banks can potentially use Aadhaar numbers to cross check with local banks and rule out the possibility of one person having multiple accounts.
- **Land records should be digitised:** This will lead to more transparency in the credit system and reduce chances of fraud.

Overall, the findings of the study provide a valuable contribution in terms of evidence to encourage better policymaking and capitalising on what has now become the major source of short-term agricultural credit.
KCC is a short-term agricultural credit scheme and therefore it is necessary to analyse the short-term fluctuations of economic growth rates. On the other hand, given the low interest rates under this scheme, further analysis is needed to understand how much of the loan given to farmers is used for consumption and farming purposes. This will also help in understanding how KCC lending affects agricultural productivity. Finally, given that the KCC scheme plays a dominant role in overall agricultural credit, research is needed on the default rates and whether this scheme has actually reduced transaction costs for banks.