



FARM SECTOR IN KARNATAKA

Farmers' Indebtedness and Risk Management

Meenakshi Rajeev and B. P. Vani

The agricultural sector in Karnataka is at crossroads with different forces operating on it simultaneously. As is well known, Karnataka is a drought prone state with comparatively low amount of rainfall. The state also has a very low share of area under irrigation and the crop patterns are dominated by low-value low-density crops. High instability in productivity coupled with increases in prices of inputs (specifically cash inputs) have resulted in a decline in farmers' real incomes. As a result farmers find it increasingly difficult to meet their production needs through their savings. This is especially true for small and marginal farmers. Consequently, credit becomes an essential need for farmers.

Rural farmer households require credit for a number of reasons including income generating and non-income generating purposes. Short term requirement of credit to meet working capital needs and long term capital needs for capital accumulation in farm sectors are well recognized. Savings of farm households being typically small, other needs such as health related expenses or social obligation are also met through borrowing. This becomes necessary in the absence of social security or other risk mitigation schemes. However institutional sources (or formal financial institutions) have been unable to meet the demand for credit for even productive purposes. It is observed that in order to access loan farmers get indebted to various sources including money lenders. Given widespread indebtedness and the resulting consequences, the issue of farmer indebtedness in Karnataka acquires added significance.

There are 4041300 farmer households in Karnataka of which 62% are indebted while the all India average is 49%. Compared to other states, Karnataka ranks fifth in terms of the incidence of indebtedness (61.6%). Andhra Pradesh, Tamil Nadu, Punjab, Kerala are the states which have higher incidence of indebtedness than Karnataka. In particular, the share of indebted farmers in Andhra Pradesh is 82%. Of the indebted farmer households in Karnataka, 60% are cultivators and 23% are involved in other agricultural activities.

This policy brief examines the nature and extent of farmer indebtedness across various economic classes and social groups in Karnataka.¹ Specifically, the brief sheds light on the problems faced by farmers in accessing credit markets through both formal and informal sources, the

role of the Kisan Credit Card (KCC) in meeting seasonal credit demand, gender differentials and access to credit, and the risk mitigating strategies followed by farmers in Karnataka, among others.² Based on an analysis of survey data as well as qualitative field observations, this policy brief suggests specific policies aimed at addressing indebtedness and risk management in the farm sector in Karnataka.

KEY FINDINGS

- ◆ One of the **important findings** from the analysis of NSSO data is that indebtedness, need not necessarily have a negative connotation which is often attached to it. Indebtedness also captures accessibility to credit as richer states or richer households within a state are found to be more indebted. Only when a loan is taken under unfavourable terms or for non-income generating purposes, and a farmer in turn is unable to repay over time resulting in perpetual indebtedness, it becomes a matter of concern.
- ◆ According to NSSO data at the all India level, 52% of loans are from formal sources and the rest from various informal sources (in terms of number of loans outstanding). Interstate variation in formal sector loans is quite noticeable. For instance, Andhra Pradesh which has highest number of loans per 100 households lags behind many other states when it comes to credit from formal sector. Out of the households that have accessed loans only 31% loans are from formal sector in Andhra Pradesh but the corresponding figure for Kerala or Maharashtra is around 83%. Out of the number of loans availed from formal sources, the share of cooperative banks is around 21% and the rest (78%) are made available by the commercial banks including regional rural banks.
- ◆ The median loan per indebted household at the all India level is Rs.10000. In terms of median loan outstanding, Karnataka stands at the 10th position with the amount little above all India average figure at Rs.10300. Haryana takes the top position with median loan outstanding being Rs.24357 followed by Kerala (Rs.22150) and Punjab (Rs.20000). In Karnataka, the median loan size from the formal source is around Rs. 15000 whereas from the

¹ For the complete report see Meenakshi Rajeev and B.P. Vani, 2010. *Farm Sector in Karnataka: Farmers' Indebtedness and Risk Management. An Assessment of the Challenges to the State*. Center for Economic Studies and Policy, Institute for Social and Economic Change.

² The results are based on two sets of data: a primary survey of households in three highly indebted districts of Karnataka (Mandya, Chamara Nagar and Haveri) as well as secondary level information from NSSO 59th Round (January-December 2003, which is the most recent macro level data set available); "Situation Assessment Survey of Farmers" covering 51770 households (at all India level) and 2009 households in Karnataka. There is not enough analysis of unit record data of NSSO by the researchers to study this important phenomenon.



informal source it is around Rs. 8000. During our survey in Karnataka many farmers reported the inadequacy of formal sector loan amounts, and hence the dependence on the informal sector.

- ✦ In Karnataka, 81% of the farmers having land holdings below 0.01 hectare access loans from the informal sector. This percentage decreases to 42% for farmers with land holdings up to 2 hectares. Further, the share of such loans coming from formal financial institutions being quite low for marginal farmers, they face a high rate of interest. The modal interest rate faced by marginal farmers is 36%, while it is around 12 – 13% for the other landholding categories. In addition, a majority of marginal farmers are from SC/ST category, 70% of SC and 66% of ST farmers belong to marginal farmer category. Further, 37% of the women headed households belong to marginal farmer category. Thus these are the groups deprived of formal sources of credit (See Table 1).

Table 1: Incidence of Indebtedness across Land Holdings in Karnataka

Land (Hectares)	Share of Households in the total sample	Incidence of Indebtedness	Amount Outstanding per Loan (Rs)	Share of loan in outstanding debt		Share of usage of loan in outstanding debt		Modal Interest Rate
				Formal	Informal	Income Generating Activity	Non-income Generating Activity	
<0.01	0.96	36.88	12073.42	18.90	61.10	24.44	75.56	36.00
0.01 - 0.40	13.26	58.37	13569.48	32.25	67.75	39.90	60.20	36.00
0.41 - 1.00	38.80	59.48	16546.10	61.68	38.32	68.44	31.56	36.00
1.01 - 2.00	21.22	65.42	19269.32	58.14	41.86	78.82	20.18	12.00
2.01 - 4.00	16.06	62.00	30450.15	74.12	25.88	87.88	12.12	12.00
4.01 - 10.00	8.42	69.40	54147.48	86.49	13.51	85.98	14.02	14.00
> 10.00	1.27	58.68	91485.10	97.00	3.00	97.93	2.07	15.00
Total	100.00	61.67	24706.94	68.89	31.11	78.04	21.96	36.00

Incidence of Indebtedness is measured as the percentage of households that have outstanding loan on the date of survey. Source: Author's analysis of NSSD data

- ✦ Importance of accessibility to credit can be seen from the fact that the marginal and small farmers having access to finance have higher yield rates. Juxtaposing the borrowers' information with that of SC/ST households shows that access to finance acts as a major constraint in the yield rate they are able to attain.
- ✦ One of the major reasons behind inaccessibility to credit is that a large number of farmers in Karnataka do not have land ownership records in spite of efforts to computerize land records. Almost all loans from the formal sector require collateral. In contrast, about 80% of the households provide no security to avail loans from the informal sector. In case of the poorest farmers (with land holding up to 1 acre), 96% provide no security to informal lender (average for 3 districts)

and as per our survey findings this percentage increases to 100 in Chamarajanagar and Haveri districts.

- ✦ Major sources of formal sector credit are commercial banks (including regional rural banks) and the cooperative banks. While cooperative banks are supposed to play a major role in disbursing farm sector credit, their role is found to be mixed in the state of Karnataka. For instance, in Mandya district the farmers have accessed loan from cooperative banks. It is important to note that wherever cooperative bank functions, it is successful in reaching out to the poor farmers. In Chamarajanagar and Haveri, however, cooperative banks have played a much smaller role in helping farmers acquire credit (See Table 2).

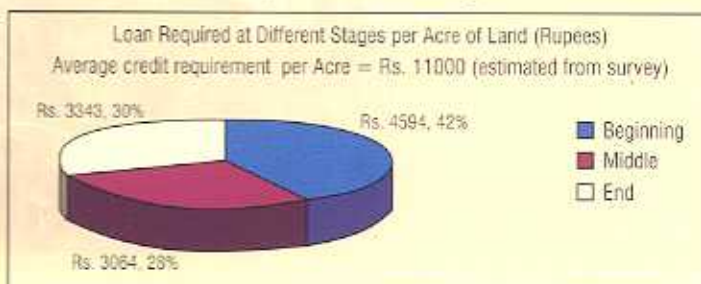
Table 2: District wise Percentage of Loans from Cooperative and Commercial Banks in Total Formal Loans by Land Size Possessed by the Households:

Land Size (Acres)	Mandya		Chamarajanagar		Haveri	
	Co-operative Bank	Commercial Bank	Co-operative Bank	Commercial Bank	Co-operative Bank	Commercial Bank
up to 1	78.3	21.7	0	0	0	100
1 to 2.5	54.3	45.7	51.1	48.9	0	100
2.5 to 5	39.6	60.2	7.2	92.8	0	100
7.5 to 10	50.9	49.1	3	97	0	100
Total	42.4	56.6	7.3	92.7	1.7	98.3

Source: Field Survey

- ✦ In addition to the issue of inadequate reach, another problem of formal credit delivery system is the following. At different points of time of cropping, credit needs are different. However, banks often provide loans at one go in the beginning. Money that remains unutilized after the first 2 months gets used for other consumption purposes. Thus money required for the harvest season gets exhausted and farmers need to then depend on the informal lenders (See Figure 1).

Figure 1: Loan Required at Different Stages of Production

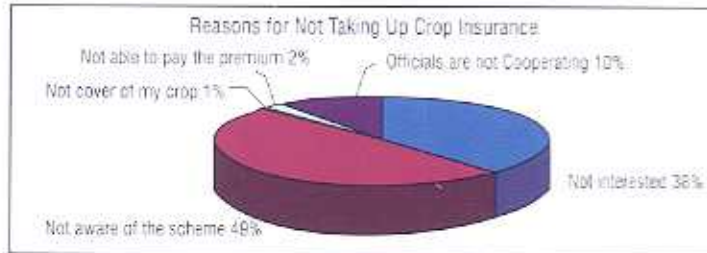


Source: Estimated from Survey

- ✦ Kisan Credit Card has been introduced to address this problem and can be a useful tool for accessing seasonal needs of credit. Though a large number of cards have been issued, farmers do not fully utilize the card. Lack of information and non repayment of previous loans are the two major reasons for sub-optimal utilization of Kisan Credit Card.
- ✦ In addition to the loan for production purposes, consumption loan becomes essential at the time of crop failure (that occurs due to natural causes) as risk mitigation instruments are yet to develop fully in the state. For instance, only 17% of the households are covered by a crop insurance scheme and the rest are uninsured. One of the major reasons for not taking up crop insurance is lack of awareness among farmers and absence of suitable insurance scheme in the regions. We

also notice from our sample that around 40% of the farmers are not interested in crop insurance (See Figure 2). This is because crop insurance is usually area based and a farmer is wary about getting compensation. Thus, the farmer considers individual-land based insurance as the best option. However, such option has premium implications which they fail to grasp.

Figure 2: Reasons for not taking up Crop Insurance



Source: Estimated from Survey

- ✦ In the absence risk mitigation instruments farmers often get overburdened with debt as a result of crop failure. In order to give relief to the farmers from accumulated debt burden Governments from time to time waive farmers' loan and one observes such waiver in the recent past. If we examine the farmers who benefited from the loan waiver scheme we observe that amongst our sample of marginal farmers only 23.5% of the marginal farmers have been benefited in case of Chamarajanagar (See Table 3). For other two districts, also the scene is not encouraging. On the other hand medium farmers with comparatively larger land holdings are benefiting at a much larger scale. Our interview with the bank officials reveals that they are now worried about the problem of willful default as the waiver has created undesired expectations amongst borrowers regarding future waiver.

Table 3: Percentage of Households who have Benefited from Loan Waiver Scheme according to Land Size in Each District

Land Size (Acres)	District		
	Mandya	Chamarajanagar	Haveri
up to 1	20	0	0
1 to 2.5	37.9	23.5	0
2.5 to 5	63.6	44.4	58.8
5 to 7.5	46.2	30.6	7.1
7.5 to 10	87.5	0	40
Above 10	75	0	44.4

Source: Field Survey

- ✦ Thus even though there exist a number of initiatives from the Government of India as well as Karnataka aimed at improving the situation of the farmers, and many such initiatives are effective, yet, these endeavours can provide more fruitful result if strengthened. Some of the policy initiatives that can go a long way are addressed in the policy section.

POLICY RECOMMENDATIONS

Accessibility to Credit

- ✦ The analysis of crop productivity across land size shows that for crops such as rice, productivity of small holdings is higher than that of medium or large size holdings. In addition, access to credit has positive impact on increments in productivity. Given that accessibility of formal credit is relatively lower for the small and marginal farmers coupled with the fact that the existing schemes do not satisfy the demand, making credit proactively available to the marginal farmer

through prioritized schemes will likely ameliorate the state of farmer indebtedness.

- ✦ As a financial institution, cooperative banks are found to be better in reaching out to the small and marginal farmers than other formal institutions such as commercial banks. However, cooperative banks always do not have the required strength to meet the demand. In some regions the cooperative banks are able to meet the expectations of the farmers but in a few other they fail to reach the target group. This is due to the systemic weaknesses. After the implementation of the revival package as per the recommendations of the Vaidyanathan Committee report (2005), it is also necessary to grant autonomy to the cooperative societies and equip them to operate as commercial units. This will likely result in a cooperative bank's long-run sustainability and effectively serve farmer needs.
- ✦ Lending by the cooperative banks is operationalised using the NABARD refinance facility. Currently NABARD refinances about 45% of the credit needs of farmers as estimated by the Apex Bank through Realistic Lending Programme. The cooperative banks find it difficult to raise the rest 55% of the resources. If refinance from NABARD increases to a larger percentage, say, 75%, that will help increase credit flow to small and marginal farmers as well as increase the size of loans made by cooperative banks.
- ✦ The rate of interest in the cooperative banks is currently 1%. It is necessary to provide funds as advances to the District Cooperative Banks in order to meet the expenditure on this account.
- ✦ The major hurdle in accessing formal credit market is the non-availability of land ownership records (RoR). Land is transferred in the family across generations but mutation (or change in the record of rights) is not effected for years, leaving the land in the name of the persons who do not own that land. Even after computerization of land records, this problem persists and severely constrains all farmers, especially the SC households. A strong and time bound drive to correct ownership records within a stipulated period will help a large section of small and marginal farmers' access formal credit institutions.
- ✦ A trend observed in Karnataka is that farmers also access credit through SHGs formed by their spouses as an alternative to informal money lenders. Sometimes SHG advances are taken even for farm production purposes. Karnataka has made good progress in formation of SHGs. However, few districts such as Haveri have lower intensity of SHGs. Special attention needs to be given to such districts where the density of SHGs is low. A special SHG drive for these districts will go a long way in reducing the role of money lenders.
- ✦ While Karnataka has a well developed SHG programme, at this stage it is necessary to monitor the workings of the already formed SHGs so



that they do not face untimely closure. Currently, many SHGs take loans for consumption purposes only while group level income generating activities are few. For sustainability and growth of SHGs, innovative income generating activities that are group based need to be developed for the SHGs.

- ◆ SHG loans though useful are smaller in size and hence inadequate for farm activities. Formation of joint liability groups (JLGs) of farmers can be a useful endeavour. Currently there are only a few JLGs. Special drive is necessary for the formation of such groups. This will solve the problem of non-availability of collateral (particularly land records) as loans given to the JLGs do not require collateral.
- ◆ Given the seasonal nature of credit requirements, the Kisan credit card has been devised as an instrument to make credit available to the farmer for needs within a cropping season. A large number of Kisan Credit Cards have been disbursed in Karnataka. However, only a few farmers (5%) have been using it in the stipulated manner. Many farmers tend to withdraw the entire eligible amount at one time using the KCC. Lack of awareness is the main reason for not making proper use of Kisan Credit Card and therefore a special awareness drive is needed to improve over time. Even a small correction in the KCC policy of compulsion of withdrawal in installments will go a long way. Keeping in view the data from the farmers cost of cultivation we suggest there could be four installments of allowed withdrawal against KCC as follows:
35%; 25%; 20%; and 20% for: 1. Sowing; 2. Weeding and Irrigation-Pest-Fertilizer; 3. Pest-Fertilizer; and 4. Harvesting respectively.
- ◆ Under financial inclusion drive there have been financial literacy missions taken up by the banks. Various existing schemes including KCC should be taken up in this drive. *Gram Sabhas* could be effectively used to disseminate such information.

Knowledge Dissemination

- ◆ Extension activities should be strengthened further for the choice of pesticides keeping in view crop vulnerability to various pests and diseases. It is also necessary to provide them at an appropriate time. Information and practice of drought resistant variety of crops needs to be enhanced by strengthening extension activities.
- ◆ A few farmers received support from the Government of Karnataka to visit countries like Japan to learn about advanced farming technique including organic farming. It is essential that such knowledge gathered need to be disseminated to the other farmers through the State agencies as well by these trained farmers.

Risk Management

The probability of a meteorological drought is very high in Karnataka. On average, every third year comes with weather related uncertainty. Given the intensity with which farm households are subjected to weather related risk, it is essential to address the issue effectively.

- ◆ Crop insurance can help a farmer during crop failure. But information about crop insurance is not disseminated sufficiently. Also, a large percentage of farmers are not interested in insurance due to the area approach that is being currently followed. It is necessary to explore whether individual based insurance could be introduced. In addition,



it is essential to inform the farmers about problems of introducing individual insurance. Group insurance schemes on the lines of the SHGs could also be considered. Such schemes could be developed keeping in view the levels of risk and farmers awareness.

- ◆ Adoption of non-farm activities can act as hedge against risk to the farmers during crop failures or other weather shocks. Most farmers consider certain petty business like opening a small shop or buying capital goods such as tractor or truck for renting as their only options. Thus there is a need to provide a shelf of non-farm activities along with required training to the farmers based on the available resources in the region to develop meaningful non-farm activities. The skill development organization of the state government can consider this option seriously and develop a shelf of activities with forward and backward linkages. New non-farm activities could be developed and supported through the Business Development Plans (BDPs), undertaken by cooperative banks.

Managing Other Expenses

- ◆ In order to understand economic situation of the farmers we also looked at the various components of expenditures that a farmer incurs. Amongst these components of expenditures, share of health expenditure is found to be significantly high. The Yashaswini card plays an important role in this regard. It is necessary to popularize the use of this card by the households belonging to the backward communities, if necessary through subsidized schemes. The scheme also should be widely spread like the Employees State Insurance Scheme.
- ◆ Similarly one can increase awareness about education loans to the marginal and disadvantaged farmers.

Access to credit forms an important factor for rural households who need credit at several stages during the farming process. Poor farmers with smaller land holdings are relatively much more deprived of formal sources of credit. These households including SC/ST and women headed households depend largely on informal sources of credit. Thus effectively addressing the problems faced by the farmers can go a long way to improve farmers' condition in Karnataka.

**Centre for Public Policy and Government
Institute for Social and Economic Change**

Dr. V K R V Rao Road, Nagarabhavi, Bangalore 560072

Phone: 23215468, 23215519, 23215592; Fax: +91-80-23217008; Web: <http://www.isec.ac.in>