Farm Sector Credit Guarantee System: Proposed solutions for small holders and farmers' collectives in India

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Prologue

- Collateral requirements of banks/FIs-Challenge for farmers and rural entrepreneurs
- Credit guarantees-Partial substitute to conventional collateral
- Guarantee systems-Policy instrument for credit flow to sectors of importance
- Credit guarantees-Part of pool of instruments for risk mitigation and credit enhancement
- If borrower fails to repay-Partial repayment from guarantor to lender

Types of Guarantees

- Individual guarantees for loans
- Guarantee on investment facility
- Portfolio guarantees
- Portable guarantees

Prevalence of Guarantee Systems.1

- First introduced in Japan (1937)
- Followed by USA (1953), Germany (1954),Italy (1960), Canada (1961)
- Market failures in credit markets-Credit guarantee schemes in most countries
- Success of SMEs in Japan, South Korea, Taiwan : High proportion of guaranteed loans (25-40 %)
- In India : Credit Guarantee Scheme introduced by Government of India, operated by Reserve Bank of India (1960-1981)

Prevalence of Guarantee Systems.2

- Credit Guarantee Corporation of India Ltd (CGCI)-Set up by RBI in 1971
- Guaranteed loans to weaker sections and priority sectors
- In 1978 integrated with Deposit Insurance Corporation to form DICGC
- DICGC extended guarantee to small scale industries (1981)
- Extended to all priority sector advances (1989)
- Guarantee function gradually wound up (2000 onwards)

Prevalence of Guarantee Systems.3

- Credit Guarantee Fund Trust for Small Industries (CGTS) set up in 2000 by SIDBI
- Renamed as Credit Guarantee Fund Trust for MSEs (CGTMSE) in 2006
- NCGTC set up in 2014 as a trustee company for various Credit Guarantee Funds
- Since winding up of guarantee function of DCGC no dedicated credit guarantee mechanism for agricultural credit as a whole in India

Pitfalls of Credit Guarantees

- Moral hazard-at both borrower & lender levels
- Intervenes in free market forces
- Unrealistic expectations of stakeholders
- Guarantee funds lose money due to inadequate supervision/appraisal

Case for Credit Guarantees in agricultural credit

- Market failures prevalent in agriculture
- Banks can meet credit needs without taking excessive risks
- Lesser collateral handling costs-lowers administrative expenses
- Facilitate credit to new client groups
- Unlocking excessive liquidity
- Overcoming difficulty of contract enforcement
- Innovations strengthen case for credit guarantee schemes

Credit Guarantee products for agricultural credit in India

- Rabofinance India : For loans to agri and allied activities through its Rabo Sustainable Agriculture Guarantee Fund
- Small Farmers' Agribusiness Consortium (SFAC) : For lending to Farmers' Producer Companies (FPCs) by banks/FIs
- Credit Guarantee Funds set up by some State Governments
- Credit Guarantee mechanisms by private sector/corporates
- These are narrow and inadequate

RBI's changing views

- Since 1990s RBI was averse to credit guarantees
- Its view was that they were market distorting
- Change in stance in now
- RBI Internal Working Group (Chairman : MK Jain, Deputy Governor, 2019) recommendation :
- "In India there is no guarantee scheme available to banks to cover the default risk of the borrowers. GoI in partnership with state governments should set up a credit guarantee fund for the agriculture sector on the lines of credit guarantee schemes implemented in the MSME sector"

Need for CGS for agri-credit in India

- Steady growth of agriculture credit in India
- Now a need for qualitative and nuanced growth
- Necessity for credit flow to collectives in agriculture like Joint Liability Groups, Self Help Groups, Primary Agricultural Credit Societies, Marketing Cooperatives, Farmers' Producer Organisations etc.
- These collectives face constraints for first round of credit from banks/FIs
- Banks/FIs need an instrument of comfort or collateral substitute

Conditions for successful Agri-CGS (IFAD)

- Sufficient demand for agriculture credit
- Supply of credit services
- Availability of professional management
- Adequately prepared and independent institution
- Availability and adequacy of technical assistance
- Appreciation of international best practices
- Adequate liquidity with banks
- Potential for sustainability

Recent developments in India

- NABARD's proposal to set up Credit Guarantee Scheme for FPOs with corpus of Rs 1 billion
- To enable higher collateral free lending by banks/FIs to FPOs
- NABARD has set up a subsidiary 'NABSanrakshan' to carry out credit guarantee and related activities
- It will act as a trustee company to manage various credit guarantee funds
- Framework created for NABARD to foray into this area in tune with RBI IWG's recommendation

Way forward

- " Credit guarantees can support pro-poor financial transactions under certain conditions by offering the partial coverage of credit risks. Credit guarantees are only effective when fully integrated into the existing financial market and managed by finance professionals who know the market well"

  - Rural Finance Policy Framework of IFAD

- ***Thus the institution which would fulfill the objective conditions necessary for setting up and successfully managing a comprehensive Credit Guarantee Fund for agriculture finance in India would be none other than NABARD***

THANK YOU