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The Role of Regional Rural Banks in the Economic Development of Northeast India: A Literature Review

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Abstract

Financial institutions are vital to the economic development of nations, particularly in rural areas. India, with its predominantly rural landscape, requires focused efforts to develop its villages. Adequate credit supply is essential for enabling rural communities to engage in economic activities. In July 1975, then-Prime Minister Indira Gandhi established a committee led by Narasimham to explore the need for rural banks as subsidiaries of public sector banks. Following their recommendations, Regional Rural Banks (RRBs) were founded on October 2, 1975, to meet the credit needs of rural communities, mobilize resources, and support economic development. This paper reviews various studies on the impact of RRBs on economic development at national and state levels, with a particular focus on Northeast India. Findings highlight that RRBs have contributed to increased income, asset acquisition, employment, and improved living standards. Recommendations include increased financing for Self-Help Groups (SHGs), cooperatives, Joint Liability Groups (JLGs), and small entrepreneurs. Despite challenges like limited infrastructure and literacy, RRBs continue to play a significant role in the rural development of Northeast India.

Keywords: *Regional Rural Banks, economic development, rural credit, Northeast India, financial inclusion*.

Introduction

In the 21st century, financial institutions are fundamental drivers of economic development worldwide, serving as essential pillars of trade, commerce, and industry. In India, these institutions have played a pivotal role in uplifting impoverished populations, particularly in rural areas. With a significant portion of India's 1.21 billion people residing in rural regions, rural development emerges as a critical component of national progress. The Northeast Region, where 84.49% of the population lives in rural areas according to the 2011 Census, exemplifies the substantial rural demographic within the country. The establishment of Regional Rural Banks (RRBs) on October 2, 1975, marked a significant milestone in India's financial landscape. Initiated under the leadership of Indira Gandhi's government, RRBs were designed as subsidiaries of public sector banks to mobilize financial resources and provide essential credit to agriculture, small farmers, artisans, and marginalized groups. This initiative aimed not only to enhance living standards but also to reduce dependence on informal money lenders, thereby fostering economic independence and stability in rural communities.

Rural development in India is intricately linked with agriculture, a primary livelihood for millions. Beyond agriculture, rural development encompasses a broad spectrum of activities – from infrastructure upgrades to health and education improvements – that collectively aim to enhance quality of life in rural areas. Despite the challenges posed by inadequate infrastructure in remote villages, including limited access to essential services like schools and health centres, financial institutions, particularly RRBs, continue to play a crucial role in bridging these gaps. By promoting financial literacy, facilitating credit availability, and supporting grassroots initiatives like Self-Help Groups (SHGs) and Joint Liability Groups (JLGs), RRBs contribute significantly to fostering inclusive growth and prosperity across rural India.

Review of Literatures

The role of financial institutions in economic development has been extensively studied. Kaye (2012) investigated the impact of the Arunachal Pradesh Rural Bank on tribal communities, highlighting significant enhancements in employment and living standards through targeted financing of Self-Help Groups and small entrepreneurs. This focus on microfinance initiatives was shown to play a crucial role in socio-economic upliftment. Ahmed et al. (2013) analysed the profitability determinants of Meghalaya Rural Bank, emphasizing its importance as an indicator of financial performance. Their findings underscored the bank's effective strategies in optimizing profitability and resource allocation. Similarly, Kher (2013) provided an appraisal of the rural credit structure in India, particularly the contributions of Regional Rural Banks (RRBs) in Gujarat. His study illustrated their significant role in supporting both priority and non-priority sectors, fostering broader economic growth.

In a critical evaluation, Adhikari and Kashyap (2013) assessed the credit deployment of Assam Gramin Vikash Bank, identifying shortcomings in credit growth and the credit-deposit ratio. They advocated for quicker loan disbursements and enhanced financial literacy to improve financial inclusion. Sarma and Borman (2014) also focused on the initiatives of AGVB, recommending infrastructural enhancements such as ATM provision to facilitate better access to banking services. Further research expanded these insights. Ahmed (2014) highlighted efficient resource utilization at Meghalaya Rural Bank, suggesting it as a model for other RRBs. Singh and Vanlalkulhpuia (2014) emphasized the need for increased microfinance in Mizoram's agricultural sector, identifying it as a critical area for development. Fanai and Singh (2015) assessed the operational efficiency of Mizoram Rural Bank, while Patel and Shah (2016) examined the impact of RRB amalgamations, noting modest growth in branches and deposits. Saxena and Lath (2017) highlighted improvements in agricultural lending by RRBs, aligning with government priorities. Kumar and Kumar (2018) discussed the broader role of banking institutions in rural transformation, supported by government initiatives. Kumar et al. (2019) evaluated the overall growth of RRBs in India, emphasizing their success in extending banking access and promoting savings among rural populations.

Agarwal and Reddy (2019) reviewed the financial strength of RRBs, focusing on deposits and credit operations. Tigari and Gaganadeepa (2019) examined the role of RRBs in rural credit structures, particularly within Pragathi Krishna Gramin Bank. Chakraborty and Shukla (2020) emphasized the multiplier effect of agricultural credit on Punjab’s rural economy, while Padhi (2020) highlighted RRBs’ support in Odisha, particularly for small farmers. Rao and Rao (2020) addressed urbanization's impact on rural economies, noting the critical role of RRBs in sustaining rural communities. Darnal and Das (2020) found that Assam Gramin Vikash and Mizoram Rural Banks outperformed others in the North East. Singh (2021) focused on the contributions of Manipur Rural Bank in deposit mobilization and credit disbursement. Finally, Barot and Japee (2021) emphasized the need for improvements in literacy and infrastructure to enhance the performance of RRBs, underscoring the multifaceted approach needed for rural development.

Objectives

The main objectives of this literature review are to i) analyse the number of Regional Rural Banks (RRBs), branch expansion, and district coverage in India and Northeast India through existing literature; ii) examine deposit mobilization in these regions; iii) evaluate the influence of loans and advances on priority and non-priority sectors in both India and Northeast India; and iv) propose actionable recommendations to enhance credit and infrastructure development for rural advancement in the region.

Research Methodology

The literature review adopts a systematic and comprehensive approach, meticulously analysing a wide range of sources to achieve a nuanced understanding of the subject matter. It incorporates peer-reviewed journal articles, reports from the Reserve Bank of India (RBI), and other authoritative resources, ensuring a thorough examination. The selection criteria for source materials prioritize studies conducted specifically within the geographical context of Northeast India. This approach not only enhances the relevance and applicability of findings to the region's unique socio-economic landscape but also provides a basis for comparing and synthesizing diverse perspectives and empirical evidence. By focusing on studies from Northeast India, the methodology aims to capture local nuances and challenges, thereby contributing to a more insightful and contextually grounded exploration of the topic.

Analysis and Discussion

Role of RRBs:

The literature highlights the critical role of RRBs in fostering economic development in rural India. Kaye (2012) demonstrated that targeted financial interventions by the Arunachal Pradesh Rural Bank significantly improved employment and living standards among tribal communities. This underscores the importance of microfinance initiatives, particularly through support for Self-Help Groups and small entrepreneurs, which enhance individual livelihoods and stimulate broader economic activity. Studies during 2010-2021 have further reinforced the role of RRBs in providing essential credit to marginalized communities, thereby promoting social equity and economic inclusion.

Effectiveness in Resource Allocation:

Ahmed et al. (2013) and Kher (2013) examined the effectiveness of RRBs in optimizing resource allocation across various economic sectors. Ahmed et al. identified key profitability determinants at Meghalaya Rural Bank, positioning it as a benchmark for financial performance. Kher's study in Gujarat highlighted RRBs' contributions to both priority and non-priority sectors, facilitating comprehensive economic growth. These findings demonstrate that strategic credit deployment and efficient resource management by RRBs lead to significant developmental outcomes. Further research from 2010 to 2021 has shown that RRBs play a vital role in channeling resources to underserved areas, thereby bridging financial gaps and fostering sustainable development.

Areas for Improvement:

Adhikari and Kashyap (2013) and Sarma and Borman (2014) identified areas for improvement in credit deployment and infrastructural support, particularly at Assam Gramin Vikash Bank. Their recommendations for quicker loan disbursements, enhanced financial literacy, and infrastructural improvements such as ATM installations are vital for improving financial inclusion and access. The broader literature, including Ahmed (2014) and Singh and Vanlalkulhpuia (2014), supports the need for increased microfinance in agriculture and efficient resource utilization, essential for sustaining rural economies. Studies conducted between 2010 and 2021 highlight the ongoing challenges faced by RRBs, including the need for technological upgrades and policy reforms to better serve rural populations. Overall, these studies emphasize the necessity for a balanced approach combining financial services, infrastructural development, and educational initiatives to enhance rural economic growth.

Growth of RRBs:

The establishment of the first five Regional Rural Banks (RRBs) in 1975 marked the beginning of a significant initiative aimed at rural economic development in India. By 2005, the number of RRBs had grown to 196, reflecting a concerted effort to expand financial services into rural areas. Despite their early promise, RRBs struggled with profitability issues for nearly two decades following their inception. In response, the Government of India initiated crucial reforms in 1994-95, accompanied by substantial capital infusion, aimed at improving their financial sustainability. As of March 2005, however, 42% of RRBs were still operating at a loss, highlighting ongoing challenges. To address these issues and capitalize on economies of scale, a consolidation program was introduced in 2005-06. This initiative unfolded in three phases: the first phase (2005-2010) focused on amalgamating RRBs belonging to the same sponsor bank within a state. The second phase (2012-2014) expanded the consolidation efforts to RRBs across sponsor banks within a state. Finally, the third phase (2018-19) implemented the principle of "one state – one RRB" in smaller states and reduced the number of RRBs in larger states. By the end of March 2021, the number of RRBs had decreased significantly from 196 to 43, according to the Report on Trend and Progress of Banking in India 2020-21. Despite this reduction, the number of branches and district coverage continued to expand robustly, reaching 21,856 branches and covering 969 districts by 2021, up from 14,484 branches and 523 districts in 2005.

Studies conducted before 2022, such as those by Singh (2013) and Agarwal (2019), have underscored the impact of these reforms on the operational efficiency and reach of RRBs. These studies highlight how consolidation has enabled RRBs to streamline operations, enhance service delivery, and improve financial sustainability, ultimately contributing to broader financial inclusion and rural development objectives. Before amalgamation, the north eastern region of India operated 11 RRBs with 645 branches, covering 60 districts in 2005. Post-amalgamation reforms, particularly evident in the 2020-21 period, reduced the number of RRBs to seven across the seven states, with no RRB in Sikkim. This restructuring aimed to consolidate resources and improve operational efficiency in the region, aligning with national efforts to strengthen rural banking infrastructure. Studies by researchers like Sharma (2015) and Dutta (2018) have documented the specific impacts of these reforms in the north eastern context, emphasizing improvements in service delivery, financial access, and economic empowerment among rural communities. These findings highlight the tailored approaches required to address regional disparities and enhance the effectiveness of RRBs in diverse geographical and socio-economic contexts.

Source of Fund for RRBs:

India, being a developing country with a predominantly rural population, emphasizes the crucial role of financial institutions in rural development. The inception of Regional Rural Banks (RRBs) on October 2, 1975, under the recommendations of a working group headed by Narasimham, marked a significant milestone in addressing the credit needs of rural communities. This initiative, initiated during Prime Minister Indira Gandhi's administration, aimed to establish rural-oriented banks as subsidiaries of public sector banks, thereby ensuring adequate credit flow to rural masses. RRBs derive their capital from three main sources in a ratio of 50:15:35 from the Government of India, State Governments, and Sponsor Banks respectively (Singh, 2013). This funding structure is pivotal for sustaining their operations and expanding their outreach in rural, semi-urban, and urban areas. Financial institutions like RRBs rely on capital, reserves, deposits, and borrowing to maintain liquidity and support their lending activities.

Studies such as those by Singh (2013) and Agarwal (2015), have highlighted the multifaceted objectives of RRBs. These studies underscore that RRBs are instrumental not only in meeting the credit needs of rural communities but also in mobilizing financial resources for agriculture, allied activities, small and marginal farmers, local artisans, small entrepreneurs, and the weaker sections of society. By fostering economic development in rural areas, RRBs play a pivotal role in generating employment opportunities, promoting savings, accepting deposits, and channeling funds towards productive purposes. Moreover, RRBs serve as a crucial bulwark against the exploitation of rural populations by informal moneylenders, thereby uplifting their living standards and contributing to overall rural prosperity. The insights from these studies underscore the foundational role of RRBs in rural economic growth and underscore the need for continuous support and strategic initiatives to enhance their effectiveness and sustainability.

Deposit Mobilization by RRBs:

Deposit mobilization is a critical function of Regional Rural Banks (RRBs), which has evolved significantly amidst the process of amalgamation aimed at consolidating their operations. Despite a decreasing number of RRBs due to consolidation efforts, the expansion of branches and district coverage has enhanced their ability to provide essential financial services to rural communities. Studies by Agarwal and Reddy (2019) highlight the crucial role of RRBs in mobilizing deposits from urban, semi-urban, and rural areas. These deposits serve as the primary source of financial strength for RRBs, enabling them to enlarge their resource base and effectively support economic activities in rural India. The process involves receiving deposits through various accounts such as current accounts, savings accounts, and other term deposit accounts.

Deposit mobilization by RRBs plays a dual role too. Firstly, it serves as a crucial source of finance, facilitating the disbursement of loans and advances to meet the credit needs of agriculture, small businesses, and marginalized sections of society. Secondly, it acts as a catalyst for promoting savings habits and fostering banking awareness among rural communities. By encouraging deposits and ensuring their safekeeping, RRBs contribute significantly to financial inclusion and economic empowerment in rural areas. The studies emphasize that despite the challenges posed by amalgamation and restructuring, RRBs continue to play a vital role in mobilizing financial resources and expanding their operational footprint. The ongoing evolution of deposit mobilization strategies underscores the importance of adapting to changing economic landscapes while maintaining their core mission of rural development and financial stability.

Loan Distribution by RRBs:

The disbursement of loans and advances by Regional Rural Banks (RRBs) plays a crucial role in supporting both priority and non-priority sectors, guided by directives and policies aimed at fostering balanced economic growth. Studies conducted before 2022 highlight the nuanced approach of RRBs in meeting the diverse credit needs of rural India. According to experts and studies such as those before 2022, bank lending to the priority sector is not only a strategic financial instrument but also a key component of Indian financial policy. This sector is accorded preferential treatment by financial institutions, including RRBs, under directives from the Reserve Bank of India (RBI) to ensure sectoral balance and equitable distribution of credit. The Government of India recognizes the pivotal role of priority sectors in fulfilling the country's fundamental socio-economic needs, such as agriculture, education, micro, small, and medium enterprises (MSMEs), housing, social infrastructure, renewable energy, export credit, and other essential areas.
RRBs, in compliance with RBI directives, have been mandated to allocate a substantial portion, often set at 75%, of their lending to the priority sector. This commitment underscores their role in promoting inclusive growth and addressing the credit needs of marginalized and economically weaker sections of society. By focusing on priority sectors, RRBs contribute significantly to national development goals, including poverty reduction and sustainable economic expansion. Conversely, non-priority sectors encompass areas where financial support is not explicitly subsidized or supported by government policies. These sectors, which may include real estate, luxury goods, and certain consumer credit segments, are deemed less critical in terms of their impact on national development and poverty alleviation efforts. Financial institutions, including RRBs, are generally more flexible in extending credit to non-priority sectors, although these sectors also contribute to overall economic growth and social development. The studies observe the importance of a balanced approach in RRBs' lending practices, ensuring that both priority and non-priority sectors receive appropriate financial support aligned with national development objectives. This approach not only supports economic diversification but also strengthens RRBs' role in promoting financial inclusion and sustainable rural development across India.

Implications

The comprehensive review of Regional Rural Banks (RRBs) and their role in rural development presents pioneering implications for stakeholders, policymakers, and academicians. The study emphasizes several crucial aspects:

i) **Importance of Rural Development**: Highlighting the critical role of rural development in fostering inclusive growth and addressing socio-economic disparities.

ii) **Establishment and Evolution of RRBs**: From their establishment aimed at providing essential credit to rural communities, to their evolution through amalgamation, reducing from 196 banks in 2005 to 43 by 2021, enhancing operational efficiency and outreach.

iii) **Sources of Funding**: RRBs derive their financial resources from various sources including capital, reserves, deposits across current, savings, and term accounts, and borrowing as needed.

iv) **Deposit Mobilization**: Crucial for financial strength, RRBs promote savings habits and mobilize deposits, supporting economic stability and growth in rural areas.

v) **Lending to Priority and Non-Priority Sectors**: Regional Rural Banks (RRBs) play a crucial role in providing loans to both priority and non-priority sectors. They significantly contribute to rural development by disbursing loans to priority sectors such as agriculture, microfinance, and weaker sections of society. While they also lend to non-priority sectors like real estate, luxury goods, and certain consumer credit segments – areas considered less critical for national development and poverty alleviation – they do so to ensure sustainable growth and overall financial stability.

vi) **Beyond Banking Services**: RRBs extend their impact beyond traditional banking by fostering Self-Help Groups, Joint Liability Groups, Farmer Clubs, and conducting awareness programs and financial literacy campaigns.

vii) **Challenges in North Eastern States**: RRBs face unique challenges in north eastern states such as legal issues, security concerns, infrastructure limitations, and low literacy levels, necessitating targeted solutions for effective rural development.

viii) **Distinct Role**: Unlike mainstream banks, RRBs focus primarily on providing financial assistance to rural poor, requiring sustained efforts to support weaker sections of society and maintain financial stability.

Thus, the study emphasises RRBs' pivotal role in national and state-level rural development strategies. By addressing challenges and leveraging their unique strengths, RRBs can continue to drive inclusive growth and improve socio-economic conditions in rural India.

Conclusion

In 21st-century India, financial institutions are key drivers of economic growth, especially in rural areas, home to over two-thirds of the population. Established in 1975, Regional Rural Banks (RRBs) have emerged as crucial agents of rural development, extending credit to agriculture, small enterprises, and marginalized groups to empower communities nationwide. Despite challenges like infrastructure deficits and low literacy rates, particularly acute in the north eastern states, RRBs have shown resilience by promoting financial inclusion and implementing impactful initiatives such as financial literacy campaigns and support for local organizations, thereby enhancing rural economies and quality of life. Looking ahead, the continued success of RRBs depends on strategic reforms, robust infrastructure development, and targeted efforts to effectively address regional disparities. By prioritizing inclusive growth and leveraging their unique position, RRBs can make significant contributions to broader national development goals and ensure a prosperous future for rural communities. Research emphasizes RRBs' critical role in enhancing rural credit structures, with studies highlighting positive outcomes such as increased incomes, asset acquisition, and improved living standards among rural beneficiaries. Moving forward, sustained focus on rural development initiatives, supported by RRBs and government programs, will be essential in advancing socio-economic transformation and reducing disparities across rural India.

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