AGRICULTURAL CREDIT IN A DEVELOPING ECONOMY—CEYLON

W.M. TILAKARATNA

Central Bank of Ceylon

P.S. Thambiah

Central Bank of Ceylon Research Series

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AGRICULTURAL CREDIT IN A DEVELOPING ECONOMY—CEYLON

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Central Bank of Ceylon

1963

Printed by the Colombo Apothecaries' Company, Limited
125, Glennie Street, Colombo, 2.

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PREFACE

This work is substantially in the form in which it was presented as a Thesis in part fulfilment of the requirements for the degree of Doctor of Philosophy of the University of London in November, 1957. The publication of the work was delayed till 1963, due to various factors. The Central Bank has now kindly undertaken to publish the work. Revision of each chapter bringing all the data up-to-date would not only have been a tedious exercise, but would also have altered substantially the study as it was originally presented to the University of London. On the other hand, the publication of the Thesis in its original form would have been a discussion of some problems which existed prior to 1957. Since then a start has been made towards solving some of the very problems raised in the study. As a compromise Chapter X has been added as a complete new chapter focussing attention on recent developments impinging on agricultural credit in Ceylon. It is necessary at the very outset to bring to the notice of readers that some of the criticisms and some of the descriptive material contained in the first eight chapters might look rather out-of-date to someone who reads it at this stage. This deficiency has as far as possible been made good in the last chapter.

Agricultural credit is a vital aspect of the problems of development in a primarily agrarian economy like that of Ceylon. Yet it is a subject which had received very little consideration in Ceylon. In the first decade of this century it was a much discussed issue. The main emphasis, however, was on the desirability of establishing Raiffeisen Co-operatives in Ceylon. Although, the Government appointed two Committees, one in 1909 and the other in 1919, to consider the question of banks for agriculturists, those reports did not consider the problems comprehensively. The Banking Commission of 1934 devoted only a single chapter to the problems of agricultural finance. The legal handicaps preventing the free flow of credit in the economy have also been studied from time to time. These have all been attempts to examine mainly the supply side of the problem, but none of them were comprehensive studies even of the problems of supply. The demand side of the problem has never been studied. Moreover, the question has not been looked at from an economist's point of view as such. Data on rural indebtedness have been available in recent years, but no attempt has been made to analyse them with a view to studying the problem of indebtedness itself, or gleaning some knowledge of the nature of demand for agricultural credit. It has always been assumed that the small farmer is oppressed by a heavy burden of chronic indebtedness and that the moneylender is necessarily a Shylock.

The purpose of this study is to fill this existing gap of knowledge on this vital aspect of development. The plan of the study is simple. Chapter I is an attempt to state the credit problems of small farmers, especially in developing countries, in general terms. The next chapter describes the context in which small scale agriculture and the credit agencies operate in Ceylon. This chapter was written largely as an introduction to readers unfamiliar with conditions of agriculture in Ceylon. It has been allowed to remain even though the study is now being published in Ceylon mainly for the benefit of some foreign readers who might wish to place the problems of agricultural credit in Ceylon in their proper perspective. Chapter III analyses the available data on rural indebtedness at the time the Thesis was written, namely, 1957. Further data on rural indebtedness have become available since then and these are mentioned in Chapter X. Chapter IV attempts to state the nature of demand for agricultural credit and the following chapter examines the problems on the supply side. The next three chapters are devoted to examining critically the available sources of credit and how far they meet the needs of farmers. Chapter IX sums up the basic conclusions of the Thesis itself and Chapter X examines the developments since the writing of the Thesis, up to 1962, relevant to the question of agricultural credit in Ceylon.

In late 1961, the ECAFE requested me to write a chapter on Ceylon for a study on agricultural finance and credit in Asia and the Far East. For the purposes of that study, I drew on some material contained in the Thesis. Now, in the writing of Chapter X, I have had to draw on material contained in that study. Chapter III on rural indebtedness was published as an article in the *Ceylon Economist* of 1958 and I am thankful to the Editor of the *Ceylon Economist* for permitting me to publish this chapter in the original form in this study. Further in 1958, I was co-opted as a member of the Committee on Agricultural Credit appointed by the Ministry of Agriculture and I then had to draw on some of the material in the Thesis in helping to prepare the chapter on *Agricultural Credit* in the *Agricultural Plan*.

The Thesis was written and the material collected in London. In a sense it has been advantageous because it has enabled me to take a detached view of the subject. The main disadvantage has been that I have not been able to make some field enquiries which I would have wished to make. Wherever possible, I have made these enquiries by correspondence with knowledgable persons in Ceylon.

In the planning and preparation of the Thesis I had the patient guidance of my Supervisor, Mr. A.D. Knox, Reader in Economics at the London School of Economics. My sincere thanks are due to him. I must also thank Mr. B.S. Yamey, Reader in Commerce at the London School of Economics, who very kindly read the preliminary draft of the Thesis and offered very valuable criticisms and suggestions. I must mention with gratitude the help I received most ungrudgingly from Professor J.R. Raeburn. I had access to books unavailable elsewhere through his private library. I made several enquiries and received prompt and very helpful replies from Mr. S.B. Yatawara, Sr., ex-Registrar of Co-operative Societies, Ceylon. I thank him most sincerely for going out of his way to help me.

My stay in London was financed by the British Government under the Colombo Plan Technical Assistance Scheme and by my employers, the Central Bank of Ceylon, who have also very kindly undertaken to publish this work. I acknowledge with deep gratitude their kind help. I wish also to thank Dr. A.M. Bohm and her staff for their very kind help during my two years stay at the London School of Economics.

W.M. Tilakaratna.

Central Bank of Ceylon,
Colombo.
April, 1963.

CHAPTER I

Introductory

Credit is of primary importance in all branches of modern economic activity. The economic history and the present economic organisation of the more developed countries bear ample testimony to the vital role of credit both in their development and functioning. Basically, credit plays the same role in agriculture as in industry. Yet the peculiar conditions of agricultural production impose certain special aspects on the problems of supplying credit to farmers.

At the outset it is necessary to have some idea of the category of agriculturists with which this study is concerned. There is no hard and fast line of demarcation between a large and a small farmer. The small farmer of one country may be reckoned as a large farmer in another. In a recent study the distinction between a large farmer and a small farmer has been stated as "the distinction between the farmer to whom general commercial credit facilities are available and suited and the farmer to whom they are not."[1] Any distinction more precise than this could be attempted only in terms of the conditions of a particular country.

Credit needs of farmers

Not all the financial requirements of a farmer are credit needs; he meets part of his needs out of current income. For the farming community as a whole any one of the individual needs may result in a demand for credit. Hence, all financial needs of a farmer are potential credit needs. From the point of view of the needs for credit there is not very much difference between the types of credit required by a small farmer and those required by a large farmer; the differences are matters of degree rather than of essence. The purposes for which a small farmer needs credit are the same as those for which a larger farmer needs credit; the one requires less of it than the other because his scale of operations is lower.

1. F.A.O. Development Papers, No. 16, *Agricultural credit for small farmers*, prepared by Bernard O. Binns.

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The financial needs of a farmer may be broadly classified into agricultural and non-agricultural needs. The non-agricultural needs may again be subdivided into productive and non-productive needs. The agricultural needs can be further classified according to the purpose and the period for which credit is required. First, finance is required for the purchase of land, clearing of land and for effecting permanent or semi-permanent improvements on the land like fencing, ridging, drainage, building factories and other essential requirements prior to the commencement of production. These can be broadly termed as the fixed capital needs of the farmer; credit would be required for long periods. The interest and debt redemption charges cannot be a charge on a single year's income; they have to be charged over a long period. The precise length of the period for which a loan is required for any one of these purposes depends on two factors, namely, the ability of the farmer to repay out of the proceeds of cultivation and the period over which such improvements can function economically without needing replacement. In the case of perennial crops even seed and initial preparation of the soil for cultivation may be considered as falling within this category.

A second agricultural purpose is for the purchase of implements, livestock, and other requirements of production which do not exhaust themselves in a single production process. Their depreciation and repair, as in the case of fixed capital, would be a current cost of production but the cost of their original acquisition must be regarded as being of a more permanent nature than current costs and of a less permanent nature than fixed capital costs. They may, therefore, be called intermediate capital and would include the purchase of implements, machines, livestock, fertiliser and such other annually non-recurrent costs. Here again, the precise period for which credit is required depends on the ability of the farmer to repay and the period of useful duration of the particular instrument of production being financed. Thus, for instance, if the farmer needs credit to manure his field every two years, each loan should be repaid during the two year period, the presumption being that such manuring gives him a sufficient additional return as would at least cover his additional costs over the two year period. Otherwise, the application of manure with such frequency and at such costs would be uneconomic. The credit would be required for a medium period, generally ranging from over a year to four or five years.

The third category of purely agricultural need is for meeting the current costs of farming and marketing. This category will consist of wages, including reasonable living expenses of the farmer and other members of his family working on the farm, repairs and maintenance of equipment, weeding, general maintenance of the land and improvements thereon, cost of fodder, cost of seed and, in general, all the recurrent needs of the business of farming, including marketing. This category may be called working capital. The need for credit arises because the farmer has to incur current expenditure but his returns are received only at the end of a season or a year, as the case may be. In the interim period between one harvest and another he needs credit to enable him to meet the cultivation costs. Further, he cannot, often, sell his crop immediately after the harvest. Between his harvest and the sale of his crop he needs credit to enable him to hold on to his stocks until they are sold. There are two important reasons why he should have credit for this purpose. First, there is usually a time-lag between the harvesting of the crop and the sale of the crop during which period he has to incur expenses for his and his family's maintenance as well as in preparation for the next crop. Secondly, a single agricultural crop is generally harvested throughout a given area at or about the same time. If all the farmers rush to sell their crops at this same time they will turn the market against themselves; there will be a glut in the market. It is in the interests of farmers as a class to release their crops to the market in a continuous flow even though their crops are harvested in two or three discontinuous stages. If there is perfect competition among the buyers of farm produce the position may be mitigated somewhat in the farmer's favour; but, where the farmer operates in an imperfect buyers' market it would be in his interests to hold stocks either individually or collectively and to release them on the market only gradually. Where middlemen hold the stocks and release them gradually to the market, they render a necessary service to the farmer. The farmers or a collective marketing organisation or middlemen will require credit for the purpose. What is required is short-term credit.

The third category of purely agricultural credit needs embraces both production and marketing credit. The credit is required for a short term only. The actual period depends entirely on the length of the production period. The interest and repayment in full are a charge on the standing crop and should, normally, be repaid out of the sale proceeds of that crop. The actual period varies with different kinds of crops, and, in general, it would range from a single season to a year.

The three categories of credit, namely, credit for fixed capital, credit for intermediate capital, and credit for working capital, exhaust the financial requirements of the farmer for purely agricultural purposes. Any particular farmer may also require credit for non-agricultural purposes, some of which may be productive while others may not be productive. The farmer may be engaged in some kind of subsidiary occupation, like cottage industries, and may need credit for the fixed, intermediate and working capital needs of the subsidiary occupation.

All the non-productive expenses of the farmer can be classified as consumption expenditure. In one sense the consumption expenditure of a farmer and the members of his family who work on the farm may be considered as necessary inputs for producing the farm output; and in that sense they would be current costs of production and hence productive expenditure. A precise distinction between productive and non-productive expenditure is not possible, especially in underdeveloped countries where the existing levels of nutrition are so low that additional consumption expenditure becomes a necessary form of investment. Nevertheless, for the purpose of analysis, it is convenient to group all consumption expenditure into one category. It is non-productive only in the sense that it is not directly connected with the process of agricultural or other production. The consumption purposes may again be sub-classified. First, there are the normal food, clothing and housing needs of the farmer and his family. The farmer must meet such basic expenses out of his income. He needs credit for such purposes not because he is spending more than his income but because he has to spend in advance of his income. This is not a situation peculiar to the farmer. Salary and wage earners and others maintain consumer credit accounts with firms for the purchase of goods during the week or the month as the case may be; and the accounts are settled weekly or monthly as incomes are received. In that case, the firms extend short term credit to their customers. What is peculiar about the farmer's case is that his income is received at very much longer intervals. Farm incomes, especially those dependent on a single crop, are received only at the time of sale of the harvested crop. Harvests take place only once, twice or at most thrice a year. The discontinuity of farming incomes may be mitigated to some extent by diversifying farm products and combining land cultivation with livestock farming, cottage industries, and other supplementary occupations. However, there are obvious limitations to diversifying the products of a single farmer; the land available may be insufficient or the soil may be unsuitable for certain crops. In general, it is true to say that farm incomes are more discontinuous than salaries, wages, and industrial and commercial incomes. Consequently, the farmer requires consumer credit for longer periods than other earners. The actual period may extend even up to a year where he has only a single crop in a year.

A second category of consumer expenditure is incurred for meeting semi-essential requirements. This category would include the education of children, recreational expenses and the purchase of semi-essential and durable consumer goods. These expenses too have to be met out of the same source of discontinuous income and hence credit may be necessary.

It is the third category of consumer expenditure which may be frowned upon as wasteful and unnecessary. These are expenses on ceremonials, jewellery and other forms of conspicuous consumption. Expenditure on such items is generally supposed to be high especially in underdeveloped countries. There is hardly any evidence to show that this is a typical characteristic of the underdeveloped countries. There can be little doubt that such expenditure is unproductive. However, the basic point is that it is imposed by the type of society in which the farmer lives; it is part of the socio-cultural environment in which he operates. Expenditure on such items constitutes a social obligation about which the farmer can do little. It may be wasteful from an economic angle but it is hardly within the province of economics to pass judgement on such behaviour by the farmer. All that can be done is to recognise the existence of such expenditure where it actually exists. The farmer would be in need of credit for such purposes as well. Perhaps, his need is more urgent than for other purposes because social obligations generally tend to take precedence over farm expenditure and, in consequence, the lack of credit for such purposes may even impair farm efficiency itself.

To sum up, the credit needs of farmers may be tabulated as follows:—[2]

(*a*) Purposes connected with agricultural production.

(i) Fixed capital—the purchase of land, clearing of land, improvement of land.
(ii) Intermediate capital—the purchase of implements, livestock, machines, fertiliser, etc.
(iii) Working capital—current costs of production, credit for holding stocks or marketing credit.

(*b*) Productive purposes unconnected with agriculture—credit required for the fixed, intermediate and working capital needs of supplementary occupations of farmers.

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2. The purposes for which credit is required have been variously classified. H. Belshaw adopted the following classification in *The Provision of Credit with special reference to agriculture*, pp. 16-20.

(*a*) Producers' Credit—"All loans which the borrower obtains with the intention of utilising them in enabling him to earn an income."

(i) Investment Credit—". . . .that form of producers' credit which is advanced for the construction or purchase of the more fixed or durable forms of capital such as railways, factories, mines or farms."

(ii) Commercial Credit—". . . .that kind of credit which is used to finance the operating expenses of a going concern."
Commercial credit required for five purposes, viz:—

1. for repairs and general maintenance of equipment.
2. to pay wages, salaries, commission, etc.
3. to hold stocks of raw material.
4. to hold stocks of finished or semi-finished goods.
5. to pay for services such as advertising and transport.

(*b*) Consumer Credit.
A.J. Boyazoglu divided the credit needs into four types in *Agricultural Credit*, pp. 153-154, namely,

(*a*) Credit for current exploitation—short-term credit.
(*b*) Credit for obtaining the consolidated means of exploitation—medium term credit.
(*c*) Real estate credit.
(*d*) Amelioration credit.

In F.A.O.—*Agricultural credit for small farmers*, the needs of small farmers were divided into 5 categories, namely,

(*a*) Social and Ceremonial obligations imposed by custom and religion.
(*b*) Personal interests of the farmer and his family, education etc.
(*c*) Recreational expenditure and durable consumer goods.
(*d*) Strictly non-agricultural—food, working clothes and housing of farm workers including farmer and his family.
(*e*) Strictly agricultural expenditure—purchase of land, improvement of land, expenditure on sources of power and implements, directly productive capital like breeding of cattle, working expenses, and technical and professional education of the farmer and other agricultural workers.

No particular merit is claimed for the classification adopted in this chapter except that it includes both agricultural and non-agricultural needs.

(*c*) Consumer purposes.

(i) Essential needs—food, clothing, housing.

(ii) Semi-essential needs—education, medical attention, recreation, purchase of durable consumer goods.

(iii) Non-essential needs—ceremonial, jewellery, conspicuous consumption.

The supply of credit

The basic problem of agricultural credit is to make available to the small farmer credit for all his needs at reasonable cost and on reasonable terms. In doing so a multiplicity of problems arise due to the peculiar conditions of agricultural production. This is especially true of small scale agriculture, the essential feature of which is the presence of a large number of small units of production. The small production unit generally operated by a single person cannot rely on the issue of shares or debentures for raising capital. Small scale agriculture as such consists of a large number of small units which are widely scattered. Their location is rural whereas financial institutions are generally located in urban areas. An urban centred bank would require a large field staff and a number of rural branches if it were to undertake agricultural lending. It would also have to maintain a large number of small accounts which hardly compensate for the additional administrative costs and business risks involved. Consequently commercial banks tend to fight shy of lending to small farmers.

There are other features of a more technical nature which tend to make the costs and risks of agricultural lending high and, thereby, to place such business outside the pale of activity of commercial banks. These arise out of the high risks of agricultural production, or the lower efficiency of capital in agriculture. Agricultural production is a biological process dependent on soil conditions, weather, pests and other vagaries of nature. Some of these natural conditions can be controlled but some, like weather, are beyond human control. In the tropics, especially, weather conditions are as important, if not more important, as human effort in agricultural production. Delayed monsoons or heavy rains or prolonged drought may result in the complete or partial destruction of a farmer's crops. Consequently, the farmer cannot determine in advance the physical return to his efforts, unlike in industrial production. His actual returns may differ very widely from his anticipated returns due to a number of natural causes beyond his control. On the other hand, he may have a bumper crop due again to particularly favourable natural conditions. In either case there is a wide margin of uncertainty about the size of the physical output. In addition, there is uncertainty about actual income. There is no guarantee that a farmer will be better off by producing a larger crop. In a season of unexpected bumper crops all farmers in a given area would have good crops and, unless the supply can be regulated to the demand for these crops, prices may fall so low that farm incomes may actually fall despite higher physical production. The farmer cannot regulate his supply to meet the demand because actual returns tend to vary widely from anticipated returns. The over-all effect of such uncertainty is that farm incomes tend to be unstable, and this is an unsatisfactory feature from the point of view of a lender.

A more fundamental disequilibrium between supply and demand may arise due to the general intractibility of agricultural production.[3] Once land has been devoted to one kind of crop it may take a very long time to switch it over to the production of a different crop should there be a change in demand due to changing tastes or the production of cheaper substitutes. This applies especially to those crops which need special preparation of the soil or which are perennial crops such as cocoa, rubber, tea, etc. Farmers may continue to produce long after the demand for a particular product has fallen merely because the land cannot be switched over to the production of a new crop without considerable delay and capital expenditure.

Further, agricultural production is seasonal. During the harvesting season a large quantity of a particular crop is brought to the market resulting in a glut. Someone has to hold the stocks and regulate the flow of supply to the demand. Where suitable marketing facilities exist farmers may obtain satisfactory prices for their produce. Where there are no such marketing facilities, the farmers have to sell their crops in conditions of over-supply in the market, consequently their profits tend to be low.

Then again, agricultural production is discontinuous and generally takes a longer period of time than industrial production. Once the

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3. H. Belshaw, op. cit., p. 63.

seed is sown the farmer has to wait three months to a year or even several years for the yield. Meanwhile his prospective income may be affected by adverse changes in demand or unfavourable natural conditions. Unlike in most industries where there is a continuous production process ranging from raw materials through semi-finished goods to the finished product, the farmer has to convert his raw material to a finished product in a discontinuous process spread over a lengthy period. The raw materials and the semi-finished products of industry are themselves marketable while the finished product of most industries appears in a continuous flow. There are no such semi-finished products in agriculture. The discontinuity of the production process makes it imperative for the farmer to have credit; the length of the production period makes such lending unsuited to commercial banks because it inhibits the quick turnover of funds required by them.

The effects of the discontinuity and the length of the production period may be mitigated somewhat by diversifying the products of each farmer. Thus he may cultivate a number of different crops which yield at different times of the year or he may engage in live-stock farming and other supplementary occupations. All these possibilities may, however, be limited by the lack of suitable land for other crops and the technical and managerial efficiency of the farmer. He may be able to cope with one crop. Each additional crop or occupation demands of him a higher managerial ability and a more versatile knowledge of the technicalities of cultivation. There are also certain soil conditions which favour mono-crop cultivation.

Agricultural crops are also more perishable than industrial products. Vegetables and fruits have very low keeping qualities. The risk of loss due to perishability is very high. Such risks may be considerably reduced by refrigeration and canning but the small farmer cannot, on his own, have these facilities. Where marketing organisations provide these facilities collectively they render considerable economies to the individual small farmer. In the absence of such facilities the risk of loss can be quite high.

All these factors, namely, the high dependence on the vagaries of nature, the intractability of production, the discontinuity and length of the production period and the high perishability of agricultural products tend to make the risks and costs of agricultural production high and the efficiency of capital in agriculture low. Consequently, lending for agricultural purposes is more risky than lending for industrial and commercial ventures.

The credit worthiness of small farmers is also inhibited by the lack of suitable security for loans. The small farmer has little besides his land to offer as security. Where absentee landlordism or some traditional system of land tenure prevails the farmer may not even own the land he cultivates. In such cases, the only security he can offer is his share of an anticipated crop, his personal character and some few movables. Lending under such circumstances requires personal knowledge of the ability and credentials of the borrower; urban centred commercial banks can hardly be expected to possess such personal knowledge. Where, however, the farmer owns the land he cultivates the position is not any the better.

Land has certain inherent defects as a form of security. Agricultural land is liable to fluctuations in value in response to fluctuations in the prices of crops. This may lead to a loss on realisation in case of default. Further, realisation generally involves a cumbersome court procedure entailing considerable delay. Meanwhile, the debtor who remains in possession of the land may extract the best out of the land and leave the creditor a worthless asset. Where the law permits the appointment of a Receiver pending a court decree the ability of a borrower wilfully to abuse the property is less. Further, default in the repayment of agricultural debt usually takes place at a time when agricultural prices, and consequently land values are depressed; it is at that time that the farmer finds difficulty in repayment. Realisation at such a time may well lead to considerable loss. That further enhances the risks of accepting land as security. The accurate valuation of land is also a difficult and technical matter which may be quite costly, thereby increasing the cost of a loan to the borrower. It may also take time which may be irksome especially if the need for credit is urgent.

A further difficulty in accepting land as a security arises due to complications of title to lands. Where there has been a proper system of registration of title the advantages are many.[4] From a credit point of view the main advantages are that it does away

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4. For a detailed discussion see Sir Ernest Dowson and V.L.O. Sheppard, *Land registration*, pp. 71-81.

with the necessity to verify a long series of complicated deeds and that it enables easy identification of the particular parcel of land offered as security. Where there is no such system, as is the case in Ceylon and most other underdeveloped countries, the verification of titles becomes an uncertain and long drawn out process lasting many months. This entails considerable delay and expenditure; delay can be quite irksome if the need for credit is urgent, additional expenditure adds to the cost of the loan, which would already be high due to valuation and other expenses.

Movables too have certain defects as a form of security. By their very nature they are movable and subsequent identification of the particular movable may be difficult, if not impossible. To overcome this the movable may be pledged and pass into the possession of the creditor. In that case the security is higher but the creditor will be faced with a problem of storage. Movables, especially bulky ones, like crops, require a great deal of space for storage. The lender would have to possess secure warehouses where the movables could be stored during the period of indebtedness. Even so, such movables may be liable to depreciation and to perish during the period and there may be loss on realisation in case of default, more so if the time of default happens to coincide with a period of low prices.

Small farmers, especially in underdeveloped areas, do not generally possess stocks and shares or insurance policies which they can offer as security. Besides their land and movables they can offer only personal security, the acceptability of which depends on their personal integrity and efficiency. Personal security would be an extremely risky form of security for long-term loans. Even for short-term loans the lender would have to possess personal knowledge of the credit worthiness of the borrower. Commercial banks do not generally consider such personal security as adequate.

To sum up, the small size of the individual farm unit, the large number and widespread of the units, the high risks of agricultural production and the lack of suitable security for loans tend to place the credit needs of small farmers outside the scope of activity of commercial banks. Consequently, the small farmer has to rely on private sources of credit. The experience of many agrarian countries of Europe, Asia and elsewhere has shown that the dependence of the farmer on private sources of credit is not in the best interests of farming. Indeed many governments have found the need to control and regulate the activities of private moneylenders and to set up special institutions to supply credit to small farmers.

Special Credit Institutions

The need for special agricultural credit institutions has long been realised. Although it is possible to quote prior instances of special efforts to provide credit for farmers it was in "the second half of the nineteenth century that rural credit was organised and developed spontaneously at the instigation of Raiffeisen and Schulze-Delitsch in Germany, Kampelik in Bohemia, Stefcik in Poland, Cerutti, Vollemborg and Luzzatti in Italy and Durand and afterwards Jules Meline and Albert Vigier in France."[5]

Special credit institutions for farm credit may be broadly classified into three types, namely, direct Government Credit Departments, public credit Corporations, and Co-operative credit societies. Government interference to provide credit for small farmers is to be seen in many of the underdeveloped countries. In Burma, for instance, the *Land Improvement Loans Act* provides for the issue of long-term loans for specific projects of land improvement; the *Agriculturists' Loans Act* authorises the issue of short and medium term loans for the purchase of cattle and equipment and for financing the annual crops, and also permits the Agricultural Department to supply seed, equipment, etc., on credit.[6] Apart from such instances of direct lending to farmers, government acts as an important secondary source of finance by lending money through special institutions and Co-operatives.

The public corporations especially created for agricultural credit purposes function under varying degrees of government control. Government may supply all or a part of the finances or may guarantee debentures issued by such institutions. There is a whole range of variation from the government owned bank to purely privately owned credit institutions although the latter is extremely rare. An example of a highly centralised government created credit system is the Farm Credit Administration of the

5. League of Nations—*Report on systems of agricultural credit and insurance*, prepared by M.L. Tardy, pp. 9-10. He cites various instances of special efforts to provide credit for farmers in France during the time of Louis XIV and later by Napoleon I and during the 1848 Republic.
6. F.A.O. *Agricultural credit for small farmers.*

U.S.A. The organisation is similar to the Federal Reserve System. The country is divided into twelve regions in each of which there are four credit institutions controlling a network of branches. The four district credit institutions are the Federal Land Bank, the Bank for Co-operatives, Production Credit Corporation and the Federal Intermediate Credit Bank. The Farm Credit Administration is the central organisation whose function is to regulate the flow of credit to agriculture and to adapt and co-ordinate the activities of the different institutions to suit the needs of the farmers. That system functions in an economic structure in which the type of small farmer which this study has in view does not exist; the American small farmer would compare only with the larger landowners and plantations in the underdeveloped regions. The institutions suited to American conditions are unlikely to be of much relevance in countries where typical small farmers own under ten acres of land each. A public corporation handling long-term farm credits, the Agricultural Mortgage Corporation, was also created by government statute, in 1928, in England, another country of comparatively large farms. An example, closer to the case in point, is the Japanese agricultural credit system, where long-term lending is handled by the Government created Hypothec Bank of Japan while a network of Co-operatives look after the short-term needs of farmers.[7] The special public agricultural credit corporations are generally state sponsored institutions and enjoy varying degrees of state patronage depending on the peculiar circumstances of each country. The important point is that such institutions must be so designed as to be able to cope with the needs of the farmers of the particular country in which they function.

The most popular type of agricultural credit institution is the Co-operative Society. Generally they lend only for short periods, although a special type of long-term co-operative credit institution, the Landeschaften, has been in existence in Germany. Co-operative credit societies are of two types, the Raiffeisen and the Schulze-Delitsch. The Raiffeisen type has unlimited liability of members, operates in a small area, has honorary members of committees, very small shares, pays no dividends, builds up its capital gradually by means of indivisible reserves and deals only with members. The

7. University of California, *Proceedings of the International Conference of Agricultural and Co-operative Credit*, 1952.

Schulze-Delitsch type had unlimited liability originally but shares are large, dividends are paid and they function like any commercial bank; limited liability was introduced later as an essential feature of these societies. The Raiffeisen type is the one particularly suited to small farmers because it substitutes collective unlimited liability for the limited liability of an individual. Where any individual farmer has little security to offer for loans, this type of society, organised as it is among a small closely-knit group of people, lends on personal security; the society itself obtains its funds on the joint and unlimited liability of its members. During the spread of the co-operative principle to various countries, from its original home in Germany, the types of societies have undergone considerable change. The principle has also been extended to activities other than credit and the two models have been variously adapted to suit local conditions.

The problems which the special credit institutions have to face depend largely on the type of economy in which they function. In an underdeveloped economy they have a special role to play under rather more difficult circumstances. It has been stated that "there is no reasonable doubt that in many countries a static or even retrogressive condition of agriculture has as a major cause a simple lack of ready money in the hands of the farmer."[8] The truth of that statement cannot be over-emphasised. In such circumstances the credit institutions should be so designed as to be able to supply, at reasonable rates of interest and on suitable terms, all the credit which a farmer needs and is capable of repaying. At the same time a credit institution should not be confused with a charitable organisation; it has to be run on business principles. Thus, such institutions should be able to combine a flexible lending policy with their own safety and solvency. In combining the twin objectives of flexibility and safety, the institutions should be especially concerned with a number of special aspects in their lending policy, namely, the period of loans, method of repayment, rate of interest, type of security, form of loan, the supervision of loans and the supply of funds. Some general points pertaining to these aspects will be discussed in the paragraphs which follow.

Period of Loan.—The farmer needs long-term, medium term and short-term loans depending on the purpose of the loan. It is

8. F.A.O. op. cit., p. 30.

important that special credit institutions should be able to supply credit for all the needs of the farmer within his borrowing capacity. From the point of view of a farmer, such a policy enables him to obtain all his credit needs at reasonable rates of interest. From the point of view of the lending institutions unless all of a farmer's needs are met, he would tend to borrow from private sources as well; since such loans are generally more expensive a farmer would want to settle them before settling his cheaper loans with the credit institutions, which are, thereby, likely to be faced with large arrears. Thus it is in the interests of the credit institutions concerned to lend to farmers for all their needs, both productive and un-productive; in any case, a well co-ordinated credit system of a country should be able to meet all such needs.

Long-term loans are required for purposes classified earlier as fixed capital. The basic criterion for long-term lending should be the prospect of self-liquidation of the loan but, in practice, this criterion is difficult to apply. The lender would have to be capable of assessing the long-term feasibility of the project to be financed. Lending institutions would require specialised knowledge of agricultural processes and should be able to judge the long-term prospects of a particular project. A second criterion is the ability of the borrower to repay the loan over the specified period. If the project being financed is the self-liquidating type the borrower would obviously be in a position to repay the loan. Having regard to these criteria, the maximum period for which a long-term loan should be given is the economic life of the project being financed; the minimum period should be consistent with the ability of the farmer to repay the capital and interest. In the case of land the period of economic life would be very long while in the case of improvements it may be quite short. There is another useful criterion which may be applied, namely, to restrict the period of a loan to the working life of a farmer. It would be desirable that the debts contracted by one farmer should not be passed down to several generations after him because the more remote the origin of the loan, the lower will be the consciousness of responsibility of the present generation. From this point of view, it would be desirable to place an upper limit of about 40 years for long-term loans.

Medium-term loans are required for purposes classified as intermediate capital. The maximum period of the loan should be the period of economic use of the asset or project being financed. For the purchase of a machine which needs replacement every three years, a loan should not be given for more than three years. In practice, it would be difficult to assess the precise period of economic use; a general average period based on past experience would be all that is possible. The ability of the farmer to repay is also important. Generally, the period of medium-term loans range from about two years to about five years.

Short-term loans are required to provide working capital and consumer needs. The short-term can be broadly defined as the period between one harvest and another. It may be as short as two months or may extend to over a year. The point is that the time of repayment must coincide with the time at which the farmer is most capable of repaying.

The *method of repayment* is closely connected with the period of a loan. The period is fixed in relation to the production process; the method of repayment must be flexible enough to cover unforeseen changes in this process. A short-term loan may be repayable in full at time of harvest but a farmer, due to unforeseen natural causes, may have no crop at all. In that event, the repayment procedure must be flexible enough to accommodate the farmer for a further period.

There are two recognised methods of repaying long and medium-term loans, the fixed instalment method and the reducing instalment method. Under the fixed instalment method the capital sum and interest repayable over the given period of years is aggregated and repayment is made over the years in fixed instalments. Each successive instalment combines an increasing amount of capital with a decreasing amount of interest. Under the reducing instalment method the capital amount is divided equally over the number of payments possible over the period. Each such fixed capital instalment is combined with the interest due on the outstanding amount of capital at each date of payment. The actual amount of interest payable would decrease in arithmetic progression. Consequently, the instalment payable decreases at each successive date of payment. The fixed instalment method has an advantage over the other because under the latter the amount of the instalment is largest at the beginning when repayment is likely to be most difficult as is generally the case at the commencement of a project. Its main disadvantage, however, is that where one instalment has to be postponed, due to the inability of the borrower to meet it, the entire subsequent repayment schedule has to be altered; whereas under the reducing instalment method it can be done by merely adding a further sum on account of interest.

The Rate of Interest.—It is not possible to lay down a definite rate of interest for loans to farmers. The rate of interest must depend on the costs of credit and the ability of farmers as a class to bear a given rate. The costs of credit consists of the costs at which the lending institutions borrow their funds, their administrative costs plus a reasonable margin of profit to cover the high risks of lending to small farmers. What the actual total cost would be would depend on the level of costs in each country. The ability of farmers to pay a given rate of interest depends on their own returns on capital. It has already been argued that the efficiency of capital in agriculture tends to be low. That would mean that farmers as a class cannot bear a very high rate of interest. On the other hand, farmers are known to pay rates of interest ranging between 100 to 250 per cent[9] to private lenders, although it cannot be suggested that such rates were consistent with their level of profits. Compared to rates charged by private moneylenders, rates of even 25 to 30 per cent must seem very low but agriculture as an industry cannot be expected to meet such interest charges. Generally, the minimum rate of interest which credit institutions should charge would be determined by the costs of the lending institution unless it is proposed to subsidise farmers as a matter of government policy; the maximum rate should have some relationship to the high risks of lending to small farmers but should not be so high as to constitute an unbearable burden on the industry.

Type of Security.—As stated earlier, small farmers do not possess too much security for loans. In many cases, the only form of security they may be able to offer would be their personal integrity and ability to work. Co-operative credit societies lend on such personal security and where there is mutual knowledge among members there is every reason why it can be operated successfully.

9. F.A.O. op. cit. page 10.

Indeed, for over a century, co-operatives the world over have demonstrated that personal security is good enough to lend to known small farmers for short periods.

It is the medium and long-term loans that raise an awkward problem of security. The type of security which credit institutions are prepared to accept must bear a close relationship to the type of asset which the small farmers possess; that would vary as between one country and another. In Eastern countries, where it is traditional for women to wear gold and silver jewellery, small farmers generally hold a part of their meagre assets in the form of jewellery. It would then be possible to utilise such assets as security by credit institutions, if they undertook pawn-broking.

In the matter of security an underdeveloped economy can get caught in a vicious circle. Because farmers do not have adequate security they cannot obtain adequate loans, because they cannot obtain adequate loans they cannot build up adequate capital and because they cannot build up adequate capital they cannot have adequate security for loans. It would indeed be fatal for the economic development of such a country to get caught up in that vicious circle. To avoid doing so, credit institutions in underdeveloped countries would have to take more risks in the matter of security than similar institutions in the more developed countries. It may be possible to cover part of the high risks by charging somewhat higher rates of interest, if that were economically possible. The important point is that insistence on very high standards of security for loans is likely to inhibit necessary development in such countries. It is also possible to reduce the risks of such a lending policy by closer supervision of the use of loans, about which more will be said in a subsequent paragraph.

Form of Loan.—A loan can be given either in cash or in kind. The main advantage of a cash loan is that it enables the farmer to choose what he wants to purchase with it. However, a cash loan increases temporarily the amount of cash in the hands of a farmer who might be tempted to utilise it for some non-essential consumer purpose. On the other hand, there are some distinct advantages in giving loans in kind. First, it automatically guarantees that the loan is utilised for a definite purpose. Secondly, there may also be certain economies. If instead of each farmer purchasing his own requirements, the credit institution were to purchase them collectively, there would be trade discounts and spreading of transport costs. Thirdly, the credit institutions may be able to purchase the requirements on hire-purchase terms, thereby, economising on their own needs of liquid capital. Despite these advantages it is not possible to grant loans in kind in all cases; it appears to be advantageous to do so whenever it is possible.

Another point of importance is whether a loan should be given in one lump sum or in staggered stages according to the progress made on the particular project being financed. If the lending institution is capable of handling such loans there would be an advantage in giving the loan in stages because it achieves a certain amount of supervision and guarantees the use of the loan for the specified purpose. This would, of course be relevant only in the case of long-term loans.

The importance of *supervision*, especially in an underdeveloped economy, cannot be over-emphasised. It has already been stated that where the security offered is not quite adequate, supervision would reduce the risks of lending. Credit institutions cannot expect to safeguard themselves with conditions similar to those imposed by commercial banks; if they do, they would find their clientele of small farmers would be quite small. They have to accept the given levels of wealth, income and behaviour of the people among whom they are expected to function; their purpose is to conduct their legitimate business of lending in that given context. They can, by their actions or influence alter the context but changes will take place only slowly. Meanwhile, their instrument of safety as well as of education is adequate supervision of the use of loans. A system of supervised agricultural credit operates in some countries of Latin America, where agricultural extension services and lending institutions work in close liaison to ensure that farmers borrow for feasible projects and that they utilise the loans for the purposes for which they were borrowed.[10]

Extension services are a matter about which credit institutions can do very little. Such services are very necessary for agricultural development. It would be advantageous for agricultural credit

10. F.A.O. Development Papers, No. 47. *Manual of supervised agricultural credit in Latin America*, prepared by Dario B. Brossard and others.

institutions to work in close consultation with the extension officers because that would enable them to gauge the technical and even economic soundness of the projects which they would be called upon to finance.

• **The supply of funds.**—Credit institutions require funds to lend to small farmers. Where government supplies all the required funds out of taxes or its own borrowings, no further problem arises. Where, however, the institutions have to obtain all or part of their funds from public subscription, their lending policies cannot be very flexible. The investors who purchase their shares or debentures would demand a minimum level of safety before they risk their money. The difficulty has sometimes been overcome by government guaranteeing the debentures of the credit institutions in respect of capital and interest. That makes them gilt-edged securities. An important source of funds can be the small farmer himself, if the institutions take steps to attract the small savings of farmers. Indeed they would be eminently suited to do so with their branch organisations at village level. The credit institutions could become the banker of the rural population. Instead of being purely lending institutions they can accept small deposits from farmers. Co-operatives already do so. It achieves a dual purpose by encouraging thrift and making more funds available to the credit institutions.

In the foregoing paragraphs an attempt was made to establish general criteria on some of the more important problems arising in connection with the provision of credit to small farmers. Such generalisations can at best give only a preliminary insight into the problem facing a particular country. As stated by Boyazoglu, "the history of each country, the special conditions of its agricultural production, the economic surroundings and its general civilisation, shaped differently its agricultural credit and the latter's branches."[11] The subsequent chapters will consider the structure and organisation of agriculture and the peculiar problems of agricultural credit in Ceylon.

11. A.J. Boyazoglu, *Agricultural Credit*, p. 51.

CHAPTER II

Agriculture in Ceylon

The importance of agriculture in the economy

The Ceylon economy has been described as "an undiversified agricultural export economy."[1] That description summarises the peculiar characteristics of the economy, namely, that it is a primarily agricultural economy producing mainly for export. The share of agriculture in the gross national product is shown in Table I below.

TABLE I

Agricultural product as a percentage of gross national product

Year		*Agri. product as % of G.N.P.*	*Year*		*Agri. product as % of G.N.P.*
1938	..	48.2	1951	..	53.9
1947	..	48.7	1952	..	50.1
1948	..	48.2	1953	..	51.4
1949	..	48.1	1954	..	53.8
1950	..	52.6	—		—

Source:—Calculated from estimates of gross national product in Department of Census and Statistics *Statistical Abstract of Ceylon.*

Agriculture has directly contributed more than fifty per cent of the gross national product in recent years. These estimates include, in the case of exports only, the cost of bringing the goods to the point of shipment. In the case of non-export agricultural products the distribution costs have not been included. Additionally, agriculture contributes to the national product indirectly as well. Commerce and the professional and other services primarily serve the needs of agricultural production. Thus, for instance, commercial banking in Ceylon, both in its origin and in its present functions, is concerned mainly with supplying the needs of export agriculture. Government revenue and the level of income and employment depend largely

1. B.B. DasGupta, *A short economic survey of Ceylon*, 1949, p. 9.

on the fortunes of the agricultural crops. All this points to the fact that large as the direct contribution of agriculture to the gross national product is, its total contribution is even larger.

The occupational pattern too emphasises the importance of agriculture in the economy. At the Census of 1946 the pattern was as follows:—

Total gainfully occupied population	2,611,524
Total gainfully occupied in agriculture	1,339,223

Agriculture provided 51·3 per cent of total employment in the economy. The occupational distribution at the Census of 1953 has not yet been published. It does not appear to have changed significantly. The Survey of consumer finances conducted by the Central Bank of Ceylon in 1953 showed that 51 per cent of the gainfully occupied population of the sample was engaged in agriculture.[2]

As in the national product there is an indirect contribution of agriculture to total gainful occupation as well. Employment in commerce and the professions is generated to a large extent by agricultural production.

The national income data and the occupational pattern indicate clearly the primarily agricultural nature of the economy. Nor is this only a recent phenomenon. It has been a feature of the economy throughout its history. During the period immediately following 500 B.C., "the chief occupation of the Aryans . . . was agriculture and they led a settled life attached to their homes."[3] The history of the period of the Sinhalese Kings is studded with numerous references to their irrigation schemes and the prosperity of agriculture. Western influence has only served to strengthen the agricultural bias in the economy. The Portuguese who ruled the maritime provinces from 1505 to 1656 and the Dutch who took over from them were pre-occupied with trade, though, of course, the Dutch made certain attempts to extend the cultivation of cinnamon. The British took over the maritime provinces in 1795-6 and the entire Island in 1815. During the British occupation, a new era of agricultural development was ushered in, based on the cultivation of coffee and later tea, rubber and coconut destined

2. Central Bank of Ceylon, *Survey of Ceylon's consumer finances*, Table 13.
3. G.C. Mendis, *The early history of Ceylon*, p. 9.

primarily for an export market. Meanwhile, peasant cultivation, naturally hampered somewhat by the growth of the plantations, continued in the same traditional manner. Consequently there has grown up two distinct sectors of agriculture. One is rooted in tradition harking back to the earliest period of Ceylon's history; the other is based on commercialised agriculture built on the best traditions of capitalist enterprise. This dualism constitutes one of the most salient features of agriculture in Ceylon.

Agriculture is more fundamentally important from a developmental angle. The Ceylon economy is underdeveloped and the need for rapid economic development is obvious. In the absence of large supplies of foreign capital, the developmental capital must be contributed, by and large, by agriculture. Secondly, any attempt to establish manufacturing industry must, at least initially, be based on a domestic market, the strength of which is determined largely by agricultural production. The lack of markets is one of the basic factors inhibiting the industrialisation of a less developed country. The foreign markets for manufactured goods are highly specialised and keenly competitive. A new country wishing to industrialise has to depend on the availability of a sufficient domestic market, at least until it can compete on equal terms with the early comers in the international markets. In the domestic market the demand for all kinds of goods is low due to the low level of income. Ceylon's national income per head of population was only Rs. 597 in the best year yet recorded. The low national income is due to low productivity. Increasing productivity is tied up, at least initially, with expansion in the productivity of agriculture which also offers a partial solution to the problem of markets for industrialisation.

Land utilisation

The latest date for which a complete set of land utilisation statistics is available is for 1946,[4] when, in conjunction with the population Census, a Census of agriculture was taken. The data are subject to the limitation that acreages, especially of smallholdings, are very rough estimates, probably arrived at by a process of compromise between Census enumerators and land owners. This is

4. The General Report of the Census of Agriculture, 1952, has not yet been published. The reports pertaining to tea, rubber and coconut have been published and will be used where suitable.

but to be expected in a country in which few people can be expected to know the exact acreages they own as there has never been a complete survey and titles to land are uncertain. Further, by definition, all holdings of one acre and under were classified as "Town and Village Gardens." Consequently, the acreages under each crop would be understated. The total area under cultivation would be unaffected but individual crop acreages would be under-estimated. In the tabulated data of the 1952 Census of Agriculture, adjustments have been made for such under-estimation; but only a part of the 1952 data is available as yet. Hence, despite their limitations the 1946 data have to be used.

At the Census of 1946, the total land area of Ceylon was 16,023,229 acres. The aggregate cultivable extent was 4,267,398 acres or 26·6 per cent of the total area. The actual cultivated extent was 3,210,101 acres or 20·03 per cent of the total area. Normally, the cultivable extent would include all potentially cultivable land. What was included in aggregate cultivable extent at the Census was only the actual cultivated area together with land "which had at some time or other in the recent past carried some form of cultivation."[5] This was the only possible course to adopt as there has not been a systematic survey of the cultivability of land in Ceylon. Nevertheless, the procedure adopted resulted in an under-estimate of aggregate cultivable extent. According to a more recent estimate, the undeveloped land suitable for future cultivation is around 3·25 million acres of which 2 million acres can be rendered irrigable.[6] This estimate too is no better than a reasoned guess. The cultivated extent too is an approximate figure in view of the difficulties of estimating the separate acreages under different crops in a large number of small holdings without the aid of a survey.

The distribution of the total cultivated area among the different crops is shown below. The table shows the disproportionately high acreage under the four major crops, tea, rubber, coconut and paddy which among them occupied 82·5 per cent of the total area under cultivation. For reasons stated earlier the separate crop acreages are under-estimates; hence, the share of the major crops in the total acreage would be even higher.

5. Department of Census and Statistics, *Census of Ceylon*, 1946, Vol. I, Part I.
6. Government of Ceylon, Planning Secretariat. *Six-Year Programme of Investment*, 1954-55 to 1959-60.

TABLE II

Land utilisation, 1946

Crop	*Extent in acres*
Tea	533,646
Rubber	574,522
Coconut	920,942
Paddy	620,780 (*a*)
Chena crops	46,322
Other crops	204,580 (*b*)
Town and village gardens	309,381
TOTAL ..	3,210,101

(*a*) The extent under cultivation in Maha 1945-46. Paddy is cultivated in Ceylon in two seasons, namely, Maha and Yala. Maha is the major season in which sowing takes place from about August to October and the crop is harvested in February or March of the following year. Yala is the minor season in which sowing takes place from about April to May and the crop is harvested in July and August of the same year. Generally the acreage sown in Maha is greater than in Yala as during the latter season not all parts of Ceylon have sufficient water for paddy cultivation.

(*b*) This is a residual figure. If the acreages under each of the minor crops were separately available the total would be higher as they are frequently interplanted.

Source:—D.C. & S. *Census of Ceylon*, 1946. *Vol. I*, *Part II.*

The land area in Ceylon falls into two zones due to varying climatic conditions. They are the Wet and Dry Zones. The Wet Zone covers about a third of the land area and has a mean annual rainfall of over 75 inches. Most of the cultivable land in this Zone is already under cultivation and the possibility of expanding the area under cultivation is extremely limited. In contrast, the Dry Zone has a mean annual rainfall of less than 75 inches and is, therefore, heavily dependent on irrigation and water-storage facilities for cultivation. Normally 75 inches of rain would be considered adequate but in the tropical climate of Ceylon the evaporation is high and hence 75 inches of rain, which falls mostly during the North-east monsoon from about November to January, is inadequate for cultivation throughout the year. Crop failure due to drought is common in this Zone and agriculture here is a much more hazardous occupation than in the Wet Zone. It is very sparsely populated and has poor transport, communication and other amenities. Consequently, comparatively large areas remain in an arid state in the Northern, North Central, Eastern and Southern Provinces of Ceylon. Until recently the area was also malaria infested. The task of extending the area under cultivation in the Dry Zone is essentially a problem of providing better irrigation coupled with colonisation with people from the densely populated Wet Zone. A scheme of state-aided colonisation of the Dry Zone has been in operation from the early 'thirties.

The structure and organisation of agriculture

TEA

The industry in Ceylon dates back to the 'sixties of the last century, although the cultivation of the tea bush was begun much earlier. Its rapid development started in the next decade when large acreages under coffee were abandoned due to the spread of the "coffee leaf" disease. The foreign (British) entrepreneurs who owned the coffee lands switched over to tea cultivation and built up a prosperous tea industry on the ruins of the coffee industry.

At the Census of 1946, the area under tea was 533,646 acres. This, as stated earlier, was an under-estimate. The acreage on the 31st March, 1946, according to the Tea Controller, was 552,853 acres.[7] The published data of the Census of Agriculture, 1952, refer mainly to estates, defined as holdings of 20 acres or more in extent. That leaves out the small holdings to which this study pertains. Hence, the structure of the tea industry is best illustrated on the basis of data published annually by the Tea Controller. His data are also likely to be more accurate in view of the statutory obligation cast on him to maintain accurate statistics to enable Ceylon to comply with the International Tea Agreement.[8]

The table below shows the total acreage at the end of March 1955, classified by size of holding. An estate, in this data, is a holding

7. *Administration Report of the Tea Controller, Ceylon.* 1954-55.

8. This agreement seeks to regulate the expansion of acreages and exports of tea producing countries with a view to avoiding oversupply in the market. All the major tea producing countries are signatories to this agreement.

TABLE III

Tea acreage on March 31st, 1955 by size of holding

Size of holding	*No. of holdings*	*Acreage*	*% of total acreage*
Small holdings below 10 acres	87,628	70,391	12
Estates above 10 and below 100 acres	1,700	46,042	8
Estates above 100 and below 500 acres	528	165,208	29
Estates above 500 acres	346	293,863	51
Total ..	90,202	575,504	100

Source:—Administration report of the Tea Controller, Ceylon, for the year of control 1954-55 (*April* 1, 1954 *to March* 31, 1955).

of 10 acres or more in extent. As much as 88 per cent of the total acreage is in the form of estates. The larger estates predominate in the tea industry. In fact, 51 per cent of the acreage is in large estates of over 500 acres. It is also seen that, while among estates there is a marked preference for the larger holding, the average small holding tends to be very small, being well below one acre in extent. The largest number of holdings are in the small holdings category but their total acreage represents only 12 per cent of the tea lands.

One of the important reasons for the predominance of the large unit in the tea industry is the fact that a large proportion of the tea acreage is foreign owned, as shown in Table IV below.

TABLE IV

Tea holdings by nationality of ownership on March 31, 1955

Nationality of owner	*No. of holdings*	*Acreage*	*% of total acreage*
Ceylonese	89,500 (*a*)	218,108 (*a*)	38
European incl. Stg. Coys.	414	261,437	45
Indian	203	21,346	4
Rupee Coys. (mixed nationality) ..	135	75,153	13
	90,202	575,504	100

(*a*) Includes small holdings of under 10 acres which are owned mostly by Ceylonese.
Source:—Same as Table III.

Forty-five per cent of the acreage is under European ownership, while a further 4 per cent is in Indian hands, bringing the total acreage under foreign ownership directly to 49 per cent. Although the Rupee Companies are registered in Ceylon, a part of their share capital too is owned by non-Ceylonese. The exact extent is not known; if it is 50 per cent, which is likely to be an under-estimate, the foreign ownership would constitute 52 per cent of the tea industry, and that too the largest estates.

In the Ceylonese owned holdings the average size of the estate is under 100 acres; the small holdings and the smaller estates predominate. The average size of the small holding is only 0·8 of an acre. The small holder does not manufacture his tea as it is uneconomic for him to own a factory, even if he could afford one. He is a producer of green leaf, which is the primary stage in the production of tea. He sells his green leaf to "bought leaf" factories, which are generally run by the larger estates. The quality of the green leaf is not uniform. The small holder's bargaining power vis-a-vis the "bought leaf" factory is necessarily small as their numbers are large and they are widely scattered and unorganised. Co-operative factories have attempted to solve this marketing problem but as yet there is only one such factory. Hence the small holder is mostly dependent on the "bought leaf" factory for the sale of his green leaf.

Not only is the tea industry largely foreign owned, it also caters largely to a foreign market. In Table V statistics of production, exports and domestic consumption are shown. The margin between

TABLE V

Tea production, exports and domestic consumption, 1947-54

Year	*Production*	*Exports*	*Domestic Consumption*
		in '000 pounds	
1947	298,526	287,259	14,249
1948	298,791	296,000	14,548
1949	298,559	297,573	14,500
1950	306,215	298,099	14,200
1951	326,279	305,171	14,750
1952	316,842	314,495	n.a.
1953	343,034	335,555	n.a.
1954	366,738	361,262	n.a.

Source:—International Tea Committee. Statistical Bulletins.

annual exports and annual production is extremely narrow, leaving little for stocks and domestic consumption. The domestic market for tea is small. This is to be expected with the low level of income. The average domestic consumption is less than 2 lbs. per head per year; this contrasts with an annual consumption of over 8 lbs. per head in England. Hence, well over 90 per cent of the tea produced is consigned to export markets in which Ceylon is the second largest supplier, India being the largest. On the average Ceylon accounts for about 34 per cent of the world exports of tea.[9]

The labour employed on tea estates is mainly of Indian nationality. In 1953, for instance, 400,619 labourers out of 489,767 were Indians on 452,163 acres of tea for which data have been published.[10] Data for earlier years show that approximately 80 per cent of the labourers on tea estates were Indians.

RUBBER

The rubber industry, in Ceylon, dates back to the last quarter of the nineteenth century, although here too the actual cultivation of the rubber tree was started somewhat earlier. The rubber industry also was started with European (British) capital and European initiative to cater to the growing world demand for rubber with the advent of motor transport.

At the Census of 1946, 574,522 acres were under rubber. For reasons stated earlier this data and the 1952 Census data are not very suitable for our purpose. A different official and authoritative source of data is available. Rubber cultivation, like tea, is closely supervised by a Rubber Controller. According to his figures the area under rubber at the end of 1946 was 659,553 acres; and at the end of 1954 it was 659,209 acres.

A breakdown of the total acreage of 659,209 acres by size of holding at the end of 1954 is shown in Table VI below. Estates of

9. The average exports of Ceylon tea as a percentage of average world exports of tea between 1947 and 1953 was 33.5 per cent.

10. *Administration Report of the Commissioner of Labour, Ceylon*, 1953.

TABLE VI

Rubber acreage at December 31, 1954 by size of holding

Size of holding	*No. of holdings*	*Acreage*	*% of total acreage*
Small holdings below 10 acres	128,740	178,609	27
Estates above 10 and below 100 acres ..	5,679	144,159	22
Estates above 100 and below 500 acres ..	657	157,849	24
Estates above 500 acres	195	178,592	27
Total ..	135,271	659,209	100

Source:—Administration report of the Rubber Controller, Ceylon 1954.

10 acres and above account for 73 per cent of the total acreage. Of the estates the largest area is in estates of 500 acres and over. Here too, like in the case of tea, the tendency is for the average size of estate to be large. However, unlike in tea, the small holding is on the average larger than one acre in extent. The number of small holdings are large and they cover 27 per cent of the total acreage.

In the case of rubber too a certain amount of foreign ownership exists but it is not so pronounced as in tea. Table VII below shows the ownership statistics. Ceylonese own 64 per cent of the acreage

TABLE VII

Rubber holdings by nationality of ownership on 31.12.54

Nationality of Owner	*Acreage*	*% of total*
Ceylonese	421,326	64
European	220,197	33
Other	17,686	3
Total ..	659,209	100

Source:—Same as Table VI.

in contrast to 38 per cent in tea. The extent of European ownership was estimated in 1934 as 45 per cent.[11] Since then it has dwindled to 33 per cent. This progressive Ceylonisation is one of the salient features of the rubber industry and has been very marked in the post-war period. It is not possible to assign any specific reasons

11. *Ceylon banking commission report*, 1934, Vol. I, p. 159. S.P. 22 of 1934.

for this tendency but a few general contributory causes have been at work in recent years. In 1931 Ceylon achieved a certain measure of self-government and, in 1948, Ceylon became independent. It would be natural for foreign capitalists to have less confidence in a fully Ceylonese controlled government and to desire to repatriate their capital. This reason alone would be valid in the case of tea as well. In rubber it would have been reinforced by the state of the industry itself. The 'thirties were largely a lean period for rubber. During the war, after the Japanese occupation of Malaya, Siam, Vietnam and Indonesia, Ceylon became the major supplier of rubber to the Allies. The strategic importance of rubber is well known. The immediate objective during the war was to obtain as much rubber as possible from the plantations in Ceylon. Rubber trees were "slaughter-tapped." Consequently, at the end of the war the rubber industry in Ceylon was in an exhausted state. According to one estimate,[12] 175,035 acres were un-economic in 1946 and within a year or two it was expected to exceed 200,000 acres. Extensive capital expenditure was indicated. With the change of political status and the resulting anxiety of foreign capital regarding its future, it would be natural for foreign capitalists to prefer repatriation to further involvement. Meanwhile, "Oedium" was threatening to reduce the rubber plantations to the impasse which the coffee plantations came to on account of "coffee-leaf" disease in the seventies of the last century. The future of natural rubber, in the face of competition from the synthetic product, too looked gloomy. The shortage of natural rubber during the war gave a fillip to the production of synthetic rubber, especially in the United States, which was one of Ceylon's best markets for rubber. The strategic importance of rubber was always known; the uncertainty of the usual sources of natural rubber was demonstrated during the war while the costs of production of synthetic rubber were found to compare favourably with those of natural rubber. All these factors contributed to the desire on the part of foreign capitalists to withdraw from Ceylon. This alone could not have achieved the transfer of substantial acreages to Ceylonese ownership but for the emergence in Ceylon of a new-rich class determined to purchase respectability at any price. Their riches were founded on imperial military expenditure in Ceylon and black-market activity fostered by war-time

12. *Report of the commission on the rubber industry in Ceylon*, 1947, p. 12, S.P. 18 of 1947.

scarcities of consumer goods. Perhaps to compensate for their disreputable activities during the war they desired to purchase land, a necessary adjunct to respectability in Ceylon at the time. This desire to purchase land coupled with the anxiety of foreign capital to withdraw would have contributed in large measure to the Ceylonisation of rubber lands in recent years.

The rubber industry, even more than the tea industry, caters to a foreign market. In Table VIII, the statistics of production, exports and local consumption in recent years are shown. Local consumption accounts for only a very insignificant part of the total production. During the war and post-war years a certain

TABLE VIII

Rubber production exports and local consumption 1947-55

Year	*Production*	*Exports* (*in tons*)	*Local consumption*
1947	89,000	82,501	71
1948	95,000	91,735	101
1949	89,500	90,489	139
1950	113,500	118,525	156
1951	105,000	103,633	218
1952	96,500	89,433	222
1953	98,610	96,679	235
1954	93,935	90,209	259
1955	93,830	97,393	267

Sources:—1. Local consumption data taken from *Administration reports of the Rubber Controller*, Ceylon.
2. Other data from the *Rubber statistical bulletin, April* 1956—International Rubber Study Group.

amount of rubber has been taken up locally for retreading of rubber tyres and the manufacture of rubber toys. Although this local demand appears to be expanding, it is nowhere close to absorbing a substantial part of the rubber produced. Consequently, the bulk of the product is exported in the form of sheet and crepe rubber. Since 1952 a new market for Ceylon's rubber has grown up in China and rubber is bartered for rice with China under a trade agreement. In the export markets, Ceylon is the third largest supplier but her total exports account for only 6 per cent[13] of world exports of natural rubber.

13. The exports of Ceylon rubber from 1947 to 1955 were 860,597 tons out of total world exports for the same period of 14,657,000 tons—i.e. 5.9 per cent.

As in the tea industry, Indian labour is employed in the rubber industry as well but not to the same extent. In 1953, 47,425 out of 91,116 labourers were Indian in the case of 253,989 acres in respect of which statistics were published.[14] Figures for earlier years too demonstrate that about 50 per cent of the labour force, on the average, is Indian. The data, however, represent less than half the total acreage. The estates which send in such returns can be expected to be the better organised estates. In the case of others too a certain amount of Indian labour would be employed but, perhaps, a lower proportion than in the case of the better organised estates.

The rubber industry, as stated earlier, emerged from the war in an exhausted state. In the post-war period the problem of rehabilitation has led to the establishment of a subsidised scheme of replanting, which will be discussed in Chapter VIII.

COCONUT

The early history of coconut cultivation in Ceylon is uncertain. As a form of cultivation it appears to have been of ancient origin but, as a commercial product, it came into prominence only in the fourth quarter of the last century. Whatever its origins may have been today it is almost a 100 per cent Ceylonese owned industry.

At the Census of 1946 the area under coconut cultivation was 920,942 acres. This figure, as stated earlier, excludes holdings of under one acre, which are likely to be very pronounced in coconut because, except in those parts of Ceylon where due to climatic conditions coconut does not grow, the coconut palm is grown even in home gardens and compounds. Since the publication of the 1946 Census report a correction has been made for this under-estimation by adding 150,000 acres, thereby bringing the total acreage in 1946 to 1,070,942.[15] Based on similar considerations the Coconut Commission estimated the acreage at 1,175,000.[16] There is no controlling authority for coconut unlike in the case of tea and rubber. The Census of Agriculture, 1952, data, pertained only to estates of over 20 acres. Consequently, due to the lack of any better data, the structure of the coconut industry in Ceylon has to be gleaned from the 1946 Census data supplemented where necessary with the 1952 Census of Agriculture data.

14. *Administration report of the Commissioner of Labour, Ceylon,* 1953.
15. Department of Census and Statistics, Ceylon, *Census of Agriculture,* 1952, Part III.
16. *Report of the coconut commission,* 1949, p. 23, S.P. 12 of 1949.

The total acreage classified by size of holding is shown in Table IX below. The small holding is here defined as a holding

TABLE IX

Coconut acreage by size of holding, 1946

Size of holding	*Acreage*	*% of total*
Small holdings below 20 acres	729,458	68
Estates of 20 acres and over	341,484	32
Total ..	1,070,942	100

Source:—Census of Ceylon 1946, *Vol. I, Part II. Sect.* 15—*Agriculture.*

under 20 acres in extent and cannot, therefore, be compared with its counterpart in tea and rubber. The small holdings, thus defined, account for 68 per cent of the total acreage. The coconut industry is primarily a smallholders' industry. The joint-stock form of ownership has not spread into it at all. In 1951, the company owned extent was only 24,507 acres. The rest consists of proprietory holdings varying in size from large estates to very small holdings of even a small fraction of an acre. Almost the entire acreage is Ceylonese owned, the foreign share being under 10 per cent.[17]

Coconut cultivation has not been conducted on the same efficient lines on which tea and rubber are cultivated. Not much attention has been paid to proper care and maintenance and underplanting and replanting have been largely neglected. Consequently the industry is today an ageing one. According to the 1946 Census data 99,539 acres were covered with trees of over 60 years of age. The Coconut Commission's estimate was much higher; in their opinion 40 per cent of the trees were over 60 years of age in 1949.[18] They recommended that replanting, on a subsidised basis, should be undertaken on a ten-year programme of replanting at the rate of 42,000 acres per year. No such scheme of replanting has yet been started, apart from distributing seedlings at a subsidised price. The rehabilitation of the coconut industry is one sphere in which finance, either subsidies or long-term loans, is urgently required.

17. Department of Census & Statistics, *Census of Agriculture*, 1952, Part III, p. 7.
18. op. cit. p. 25.

The coconut industry differs from tea and rubber in at least two further aspects. First, it has a large domestic market as the coconut kernel, its milk and oil are important ingredients in Ceylonese food preparations. Secondly, coconut cultivation forms the basis on which a number of processing industries have grown up. The chief products of the processing industries are copra, coconut oil, dessicated coconut and poonac. There are also a number of other industries for which the basic raw materials are provided by the coconut palm. These include the distilling of arrack and gin, the production of jaggery, vinegar, soap, coir and fibre.

The industry caters both to a foreign and a domestic market. In the domestic market it is primarily a food product and the quantity consumed would tend to vary directly with population. In the context of a rapidly expanding population the domestic market for coconut products would tend to expand. If the position of the industry as one of the three major foreign exchange earners is not to be seriously jeopardised, higher production would be necessary. This higher production has to come from increased productivity and rehabilitation of the industry itself as further extension in acreage appears to be ruled out in view of the large acreage it already occupies and also the possibility that extenstion may result in bringing marginal lands into cultivation. Rehabilitation, as stated earlier, is largely a problem of finance.

The total production in estates and small holdings was 1,191,275,000 nuts in 1945, according to Census data. The Coconut Commission's estimate for the same year was 1,809,791,041 nuts. This latter estimate includes domestic consumption estimated at the rate of 140 nuts per head per year. This average consumption figure was not based on a survey and hence its accuracy is doubtful. The Central Bank's survey of consumer finances showed a domestic consumption of 115.26 nuts per head. The estimated production, domestic consumption and exports of coconuts, are shown in Table X below. The figures must be taken as rough estimates only in view of the methods of estimation used. No allowance has also been

TABLE X

Estimated production of coconuts, 1948-1954

Year		*Local Consumption*		*Exports* (*c*)	*Total*
		Domestic (*a*)	*Industrial* (*b*)		
			In '000 *nuts*		
1948	..	786,314	30,347	978,591	1,795,252
1949	..	809,798	30,469	953,045	1,793,312
1950	..	837,530	30,469	1,039,287	1,907,286
1951	..	859,281	40,625	1,269,752	2,169,658
1952	..	881,254	40,625	1,462,351	2,384,230
1953	..	905,003	48,750	1,268,979	2,222,732
1954	..	930,527	36,084	1,180,143	2,146,754

(*a*) Based on the adult equivalent of the population as obtained in the Census of 1946, and the consumption of coconut and oil per head adult according to the Family Budget Survey of 1950.

(*b*) Estimates based on figures of consumption of coconut oil in the soap manufacturing and other industries furnished by the Department of Industries, the Department of Commerce and in the Census of Industry 1952.

(*c*) From the Ceylon Customs Returns. The conversion factor's used are—

1 ton of coconut oil	=	8125 nuts
1 ton of copra	=	5000 nuts
1 ton of desiccated coconut	=	6900 nuts
1 gallon of coconut oil	=	33.55 nuts

Source:—Department of Census and Statistics, Ceylon, *Census of Agriculture*, 1952, *Part III.*

made for changes in stocks. The last column is, therefore, not the total production. Even though the data are subject to such limitations, the errors are unlikely to vitiate the conclusion that a large proportion of the total product of the coconut industry is absorbed by the domestic market. The very small producer probably consumes the bulk of his product and there is a substantial non-market subsistence element in the coconut industry. Ceylon is the third largest exporter of coconut products and total exports account, on the average, for about 10 per cent of world exports.[19]

Coconut is not a labour intensive crop. Once cultivated, the tree yields after about seven to eight years and needs little attention. Of course, with attention, the yield would be higher, but some yield is obtained with very little or no attention at all. Thus it

19. See *Vegetable and Oil Seeds*, 1954.

qualifies eminently as a subsidiary form of cultivation. In the larger estates there would be a seasonal demand for labour for plucking, weeding or manuring but the regular demand is confined to, in most cases, a watcher to safeguard the crop from theft. Consequently the amount of employment offered by the coconut industry is small especially in comparison to tea and rubber where a regular labour force is essential for production.

PADDY

Paddy cultivation is the mainstay of rural agriculture. It is indeed more than a means of livelihood; it is a way of life. It pervades the entire socio-economic life of the village. The village customs, ceremonials, festivities and the general socio-cultural basis of rural life are to be found rooted in the system of paddy cultivation.

At the Census of 1946, the area of paddy lands, exclusive of 13,270 acres within estates, was 899,970 acres. Only 607,510 was under cultivation in the maha season of 1945-46. There were a total of 771,908 holdings. The average size of holding was 1.2 acres. However, there was wide regional divergence in the size of holdings, which varied from 6.9 acres in the Batticaloa district to 0.6 of an acre in Kandy and Matale districts. The distribution of holdings by size is shown in Table XI below. As much as 31 per cent of the holdings were smaller than ½ acre while 64 per cent of the holdings were under 1 acre in extent. The median size of holding was only 0.78 of an acre. The larger size of holding of over 5 acres accounted for only 4 per cent of the holdings but occupied 30 per cent of the

TABLE XI

Asweddumized (a) paddy lands (exclusive of paddy lands within estates) by size of holdings, 1946

Size of holding	*No. of holdings*	*% of all holdings*	*Acreage*	*% of total acreage*
Below ½ acre	242,690	31	58,005	7
½ acre to below 1 acre	253,823	33	147,376	16
1 acre to below 2 acres	162,120	21	193,794	21
2 acres to below 5 acres	85,310	11	231,726	26
5 acres to below 10 acres	19,705	3	122,073	14
10 acres and over	8,260	1	146,996	16
Total	771,908	100	899,970	100

(*a*) Asweddumized paddy lands—"mud land prepared for the cultivation of paddy."

Source:—Census of Ceylon 1946, *Vol. I, Part II.*

acreage. A feature of paddy lands is that, while the bulk of holdings are small, over 30 per cent of the acreage is held in few comparatively large holdings. Part of the explanation for this is to be found in the fact that in government sponsored colonization schemes the smallest holding of paddy is over 3 acres in extent. In the rural areas, proper, the size of holding is small. Historically, this is due in large measure to inheritance laws under which land passes to all issue in contrast to primogeniture where the eldest child is entitled to the land. With each succeeding generation the size of holding becomes smaller and smaller and holdings of 1/500th of an acre are not unknown in Ceylon. The farmer is also prevented from acquiring additional land due to the poor income accruing from his fragmented holding and continues to pass on to succeeding generations an even smaller plot per head.

Paddy cultivation is the preserve of the peasant cultivator who earns a meagre living from it. Large scale enterprise has probably fought shy of paddy cultivation for the economic reason that it is not profitable. Even this, however, has yet to be proved. Rice is the staple diet of the Ceylonese. Its large scale production is not hampered by the lack of a market. Being an article of food the local market cannot be protected from foreign competition, until local supplies are adequate to meet the demand. The import and distribution of rice has become a monopoly of Government since the war. The price to the consumer too is subsidised; but this cannot have a detrimental effect on local production since the government is prepared to buy local supplies at a guaranteed price. Despite this, large scale private enterprise has fought shy of paddy cultivation. An explanation for this is probably found in the fact that land available for paddy cultivation in the Wet Zone is extremely limited and that any large scale cultivation must take place in the Dry Zone. As already stated cultivation in the Dry Zone is an extremely hazardous venture. Possibly the return on paddy cultivation as at present is insufficient to compensate for this high risk. The Government has undertaken large irrigation works in the Dry Zone and once these are properly under way the position might change as such overhead facilities would result in considerable economies to private enterprise in paddy cultivation.[20]

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20. In the past the Government has offered to capitalists for development some village tanks and the adjacent lands but there has been no response.

Estimates of production of paddy have been made for recent years on the basis of crop cutting surveys. They are shown in Table XII below. It is seen that the annual production varies considerably

TABLE XII

Paddy production (in '000 bushels)

Year		*Maha*	*Year*	*Yala*	*Year*	*Total*
1951-1952	..	18,400	1952	10,500	1952	28,900
1952-1953	..	13,200	1953	8,700	1953	21,900
1953-1954	..	19,300	1954	11,800	1954	31,100
1954-1955	..	21,700	1955	14,000	1955	35,700

Source:—Department of Census and Statistics—Statistical Abstract, 1956.

from year to year. This is, of course, due to the fact that paddy cultivation is dependent largely on the vagaries of nature. The entire production is for the domestic market but the total supply is inadequate to meet requirements. Consequently, about half the supply of rice comes from foreign sources, mainly China and Burma.

The employment of paid labour is not very common in paddy cultivation. The demand for labour is seasonal and the usual method employed is joint-work under a system of mutual exchange of labour. Under this system all farmers in a village would assist each other in the various stages of cultivation. The payment for such services would be made by each farmer having to work in the fields of others in turn. The women do likewise at the time of transplanting.

CHENA CULTIVATION

This form of cultivation has been described as the rotation of land instead of the rotation of crops. The cultivator cuts down and burns a block of forest land on which he cultivates cereal crops like kurakkan and maize as well as vegetables. He cultivates the same plot twice in succession and thereafter abandons the land and proceeds to cultivate yet another block in similar fashion. Once abandoned the plot is allowed to lie fallow for fifteen to twenty years until it is fully covered with secondary forest and until it recovers from the exhaustion of chena cropping. Thereafter, it is felled and burnt for the same purpose.

The evils of this form of cultivation, especially its ruinous effect on forests, are obvious; but, chena cultivation has become an essential part of the rural economy. It is a direct consequence of the limited scope provided by permanent cultivation due to scarcity of land and the pressure of an expanding population on even the little land available to the rural cultivator. The need for such an outlet has received state recognition in that the Government allows cultivators to convert crown lands into chena under a permit system. Nevertheless it is only a palliative to the land hunger of the rural population and can never be a substitute for permanent and settled cultivation.

At the Census of 1946, a total area of 221,395 acres was enumerated as chena lands out of which 46,322 acres were actually under cultivation at the time. The remaining 175,073 acres indicate the total land area which would lie abandoned under this form of cultivation in any year. That it is a wasteful form of cultivation cannot be denied; but, that it is a necessary evil under the circumstances would be equally true.

OTHER CROPS

The other crops may be divided into minor export crops and rural highland crops.

Minor export crops.—Under this residual category may be listed cinnamon, tobacco, cardamoms, arecanut, citronella, cocoa, etc. Statistics of acreage and production of these crops are not available.

At the Census of 1946, the area under all "other crops" was 204,580 acres. This figure excludes acreages of such crops interplanted with the three major crops. However the minor crops are themselves interplanted with one another. As the acreage under the various crops were not given separately it is not possible to gauge the relative importance of each of the crops.

All these minor crops are cultivated by Ceylonese mainly. The extent of foreign capital in such crops would be negligible.

No production data are available. However, as these products are exported, export statistics can be used as an indicator of production. In Table XIII the quantities exported of minor crops are shown for each of the two years 1952 and 1953. The amount of domestic consumption of these crops is not known. The quantities exported are small and form a minor proportion of the total exports.

TABLE XIII

Exports of minor crops

Crop		*Quantities exported in* 1952	1953
Cinnamon	cwts.	50,315	55,010
Cinnamon oil	ozs.	1,882,712	1,465,195
Cocoa (raw)	cwts.	58,050	55,010
Cardamoms	cwts.	2,461	2,070
Citronella oil	lbs.	1,159,041	1,419,315
Pepper	cwts.	—	3,685
Arecanut	cwts.	129,918	96,519
Papain	lbs.	217,045	396,012
Tobacco (unmanufactured)	lbs.	1,182,336	786,089

Source:—Administration report on customs and shipping, Ceylon 1953.

The total contribution to the national product by all these minor crops is under Rs. 100 million. Of these, cinnamon was at one time the major export crop of Ceylon. The Portuguese, the Dutch and the British vied with one another to obtain the monopoly of the cinnamon trade of the Island. That was prior to the new era of agricultural development which commenced in the 1830's and which brought in its wake the coffee, tea, rubber and coconut plantations. Cinnamon became a minor crop in consequence.

The distinguishing feature of the minor crops would be their small scale cultivation and their minor significance in the total product of the economy. From the point of view of employment offered too they are likely to be unimportant but like all small holdings they would keep a proportionately larger number of people in a state of semi-employment or provide others with a subsidiary occupation.

Rural highland crops.[21]—The rural population cultivates a variety of crops in their home gardens and in their small holdings of highland. These crops include coconut, arecanut, jak, breadfruit and pepper and a number of root crops. There is no systematic

21. These lands have been called highlands purely to distinguish them from paddy lands.

cultivation. All these crops are quite indiscriminately interplanted and their separate acreages are not precisely known. The Department of Census and Statistics has compiled a list of food crops and their acreages on the basis of Headmen's returns. Needless to say that such estimates are liable to a wide margin of error. They are grouped into convenient categories in Table XIV. There are over 20 crops included in the different groups. The groups acreages as well as the acreages under each crop would be exaggerated due to the wide prevalence of inter-planting.

TABLE XIV

Food Crops—Acreages

Crop	*Maha* 1953-54	*Yala* 1954
Cereals (*a*)	106,383	87,679
Pulses	15,511	10,995
Edible root crops	118,382	124,364
Other crops	157,999	34,262

(*a*) Excluding rice.

Source:—Department of Census and Statistics—Statistical Abstract 1955.

These highland crops generally supply the farmer with a subsidiary source of income and in some cases, the only source of cash income. Highland cultivation is not only an important source of subsidiary cash income, it also enables the farmer to cultivate his domestic requirements of vegetable and secondary foodstuffs.

THE SMALL FARMER

Our study pertains to the problems of the small farmer in Ceylon. It is, therefore, necessary to arrive at a working definition of the small farmer and small scale agriculture. The majority of holdings in Ceylon would be classified as small holdings if they are classified according to the size of holdings in more advanced countries. If, however, classification is made within the existing range of sizes in Ceylon, it is possible to distinguish, though imprecisely, between small and large holdings. The main difficulty in attempting such a classification is to set a size limit to a small holding. For the purposes of the Ceylon Census of 1946, a small holding was defined as a holding of under 20 acres but over one acre in extent. Holdings below one acre were classified as "Town and Village Gardens"; paddy lands and chena lands were separately classified. The definition of a small holding adopted by the Tea and Rubber Controllers is a holding of under 10 acres. Comparable data for crops other than tea and rubber are not available and consequently it is necessary to fall back on the Census data. If 20 acres is adopted as the line of demarcation between a small and a large holding, the number and extent of small holdings in Ceylon would be as shown in Table XV. It is seen that out of a total cultivable extent of 4,267,398 acres, 60 per cent fall under small holdings, thus defined. Small scale agriculture, classified purely by size of holdings, would, therefore, consist of 2,117,578 holdings covering a total cultivable extent of 2,633,328 acres; on the average, each

TABLE XV

Small Holdings in Ceylon, 1946

Description	*No. of holdings*	*Acreage (a)*
Small holdings (*b*)	394,782	1,110,750
Town and Village Gardens ..	858,892	401,213
Paddy lands (*c*)	771,908	899,970
Chena lands (*d*)	91,996	221,395
Total ..	2,117,578	2,633,328

(*a*) Total cultivable extent.
(*b*) According to Census definition, i.e. under 20 acres but over one acre.
(*c*) Excludes paddy lands within estates. Includes a small number of holdings of over 20 acres because the Census classification did not have a separate over 20 acre class for paddy lands. However, all holdings of over 10 acres accounted for only 1% of total holdings covering only 8,260 acres. Hence the error is classifying all paddy holdings as small holdings (i.e. under 20 acres) is likely to be very small.
(*d*) All chena lands are classified as small holdings because no chena holding is likely to be more than 20 acres in extent.
Source:—Census of Ceylon, 1946. *Vol. I, Part II.*

holding is slightly over one acre. This definition of small scale agriculture is the same as the definition of the rural sector adopted for the purposes of the Economic Survey of Rural Ceylon 1950-51. As we shall have to depend heavily on this survey especially for data on rural indebtedness, it is advantageous that the small farmers sector for our purpose is identical with the rural sector.

The size of the holding, by itself, is, however, an insufficient criterion for distinguishing between small scale and large scale agriculture. The nature of production too has to be considered. A qualitative distinction has to be made. Whereas the system and techniques of production adopted by a 30 acre holding may be typically small scale, a small holding may adopt more economical techniques. These qualitative differences are likely to arise mostly around the 20 acre line of demarcation. Consequently, the precise classification adopted in the previous paragraph would tend to become somewhat vitiated. However it is not possible to make any adjustment for such qualitative differences.

The small farmer is engaged in small scale agriculture as defined above. A rough estimate of their numbers can be attempted on the basis of the Census data on gainful occupation. In 1946, according to Census data, there were 550,464 persons engaged in food production. Of those engaged in the cultivation of commercial crops, if plantation labour and managerial staff are deducted, there would be a balance of 111,087 persons who would have been engaged in small scale agriculture. This, together with those engaged in food production, works out to a total of 661,551 small farmers, small scale agriculture being their chief occupation. However, every villager is an agriculturist although his chief occupation may not be agriculture. Further, an allowance must be made for increase of the working population between 1945 and the present date. Making a very rough allowance for these two factors, the number of small cultivators is likely to be about a million. Any system of agricultural credit has to deal with about that number of small cultivators at present and a larger number as the agricultural population and the area cultivated expands.

An alternative method of estimating the number of small farmers to whom credit has to be made available is on the basis of population. At the Census of 1946, the distribution of population among different sectors of the economy was as follows:—

Urban Sector	—	15.3 per cent
Estate Sector	—	12.8 per cent
Rural Sector	—	71.9 per cent

In the Census data too the rural population was defined as those living in holdings of under 20 acres in non-urban areas. Applying the same ratios to the mid-year 1955 population and assuming that the size of the rural family has remained unchanged since 1950-51, when it consisted of 4.5 persons per family,[22] the number of rural families in 1955 would have been approximately 1.3 million. Since all rural families engage in some form of agriculture though that may not be the chief occupation of some, the number of farmers with whom the credit system will have to deal will be 1.3 million, on the further assumption that there will be only one farmer per family. The rural small farmer sector in Ceylon consists of 1.3 million families.

The unit of organisation in rural Ceylon is the village. One or more villages are grouped together into a **Gansabha**, a Village Committee, which is the smallest unit of local government in Ceylon. The Gansabha is an elected body and regulates village irrigation, roads and other village works. The representative of the Central Government in the village is the Village Headman who may have more than a single village under his supervision. He is responsible for the maintenance of law and order and acts as the medium through which the Central Administration maintains contact with the people. The village is a closely knit unit and often people of the same caste or same ancestral family occupy a single village. Due to such caste or family ties the social and occupational mobility of the villager is necessarily limited. The impact of education and urban life on the rural economy has tended to undermine the insularity of the village unit but this process has not proceeded far enough to disintegrate the village as a social and economic unit. A certain shift of population from the village to the urban areas too has taken place. Thus, for instance, the urban population has increased from 11 per cent to 15 per cent of the total population between 1891 and 1953. However, considering the period of time involved, this shift cannot be said to show a significant tendency towards urbanisation. Perhaps while the population continues to live in the village, the character of rural life itself has changed and made a shift to the towns unnecessary. The radio, the newspaper, the touring cinema and the itinerant trader have in their own small ways brought the amenities of urban life closer to the villager. Nevertheless there remains a wide gulf between the social and economic life of the rural villager and the urban dweller.

22. Department of Census and Statistics, *Final report of the economic survey of rural Ceylon*, 1950-51. S.P. XI of 1954.

In the village the family is the economic unit. The typical family would depend on its paddy field, small holding of highland and chena cultivation and may sometimes have one or more of its members earning additional cash incomes from work outside the family holdings. There may be regional exceptions to this typical family in the case of a village specialising in some kind of handicraft or in the coastal areas where fishing would be the chief occupation.

Occupational Pattern.—Data on the occupational pattern and many other facets of rural life in Ceylon have become available through the economic survey of rural Ceylon conducted by the Department of Census and Statistics of the Government of Ceylon. The data, are, however, subject to certain limitations. The report on the survey itself stated, "the figures given in this report are likely to be subject to varying degrees of error. It is better to take them as approximations and indications rather than as rigid conclusions."[23]

The occupational pattern as revealed by the survey is shown in Table XVI below. The unit of investigation was the family and consequently the distribution is on the basis of the chief occupation of the family. The report[24] expressed the view that "most families have only one important earner, and even where there are more, they are generally engaged in the same kind of work. An analysis of family occupation is thus also more or less an analysis of individual occupations." It is difficult to agree with this view for a number of

TABLE XVI

Distribution of families according to predominant occupational activity in the rural sector, 1950-51

Chief occupation	*No. of families in sample*	*% of total families in sample*
Agriculture	8,733	40
Trade	1,534	7
Handicrafts	1,114	5
Labour (non-agricultural) ..	3,824	17
Other	6,877	31
	22,082	100

Source:—Final report of the economic survey of rural Ceylon, 1950-51. *S.P. XI of* 1954.

23. op. cit. p. 12.
24. op. cit. p. 27.

reasons. First, in the case of agricultural families all adult male members and most of the females as well would be engaged in cultivating the land, as usually happens in the village. This may apply to cottage handicrafts as well. But in the case of trade, labour and other occupations the pattern can generally be expected to be of one earner maintaining the others who even if they be gainfully occupied would not necessarily follow the same occupation. Due to these differences between the number of persons gainfully occupied and in the same kind of occupation as between families belonging to different occupational categories in the above table, the distribution of individual occupations is likely to differ widely from the distribution of family occupations. Since such differences are likely to be marked in the case of agriculture and handicrafts, the above table probably under-estimates the relative importance of agriculture and handicrafts. A second reason for supposing that the individual occupational distribution is likely to be different is that only 40 per cent are occupied in agriculture. The occupational distribution for the whole of Ceylon, at the Census of 1946, showed that 51 per cent of the gainfully occupied were engaged in agriculture as the chief occupation. The pattern for rural Ceylon can be expected to show only a higher dependence on agriculture but the survey data show that a smaller number of families depend on agriculture as the chief occupation. Assuming that the sample was representative the conclusion must be that the family-wise classification vitiated the individual occupational pattern. Possibly the method of sampling on the basis of village units rather than population gave rise to the selection of some atypical villages specialising in one kind of occupation. All this casts serious doubts on the occupational distribution in the above table. Probably agriculture has been understated; nevertheless, it is still the rural sector's most important occupation.

Rural agriculture is mainly concerned with food production. One of its basic features is the very small extent of land owned by each family. It is seen from Table XVII that most of the family holdings are small. For purposes of enumeration, all holdings owned by one family would have been grouped together, thereby concealing the small size of the average unit of farming. Land is the primary source of income of the agricultural family but 26 per cent of them had no land. They were probably agricultural labourers or share croppers. A further 16 per cent had less than half an acre, which can give a family of four to five persons only a very small income. In a rural economy land is not only important for the primarily agricultural family. Every villager is an agriculturist even though that may not be his chief occupation. Among non-agricultural families 45 per cent owned no land at all. The median size of holding

TABLE XVII

Ownership of land by size of family holding in rural Ceylon, 1950-51

Extent of land	*No. of agri. families*	*No. of non-agri. families*	*All families*
No land	2,300	6,014	8,314
Less than ½ acre	1,396	3,378	4,774
½ acre and less than 1 acre ..	1,033	1,466	2,499
1 acre and less than 2 acres ..	1,310	1,203	2,418
2 acres and less than 3 acres ..	793	513	1,306
3 acres and less than 4 acres ..	519	263	782
4 acres and less than 5 acres ..	365	176	541
5 acres and less than 10 acres ..	646	218	964
10 acres and less than 15 acres ..	213	58	271
15 acres and less than 20 acres ..	63	11	74
20 acres and over	95	44	139
	8,733	13,349	22,082

Source:—Same as Table XVI.

in the entire sample of agricultural families was only 0.82 of an acre which should be reckoned as too small by any standards. A further feature of the distribution of land is that there are a few families which own comparatively large holdings. In the 108 villages there were 139 families owning more than 20 acres each. In most villages there are one or two comparatively rich families which own the larger holdings in the village. These families do not generally cultivate all their land but get them cultivated under some form of tenancy. The types of tenancy are ancient in origin and hark back to ancient Ceylon, in which the King was the owner of all the land. His subjects cultivated the land and received a proportion of the crop in payment of their services. The King also gave a part of his land to his Chiefs for ruling the various provinces and to others in payment for services; these recipients of royal grants became land owners in their own right. In course of time the lands changed hands but the original pattern of land ownership, however depleted the size of holdings may be, has continued. The feudal ties between landlord and tenant have largely disappeared. All that remains of the ancient system is that some few families in the villages own comparatively larger extents of land while the majority of families are almost landless. Nevertheless, even those families which own more land than the rest are by no means large land owners comparable to the Zemindaries of India and the average farmer of countries like England and the U.S.A. They too are small land owners but are better off than the bulk of the rural population which is almost landless.

A distinct feature of the rural economy is the low income of the people. According to data collected at the 1950-51 Survey, the average income of the rural family of 4 to 5 persons was only Rs. 96.80 per month, the median being only Rs. 77.52. The average family spent Rs. 85.20 per month and saved the balance. Only 67 per cent of the families had a surplus of income over expenditure; 30 per cent of the families were in debt. These figures were affected by the boom conditions prevailing during the Survey period due to the Korean war. In normal times the income would be less and the margin available for saving much less. The Survey data show the farmer in a better condition than he normally is in. Nevertheless, the figures tell a woeful tale. The standard of living possible on Rs. 85.20, just over £6 per month, is necessarily low for a family of 4 to 5 persons. In the words of B.R. Shenoy, "The keynote of the economy is poverty and its foundation the low returns from land."[25]

To sum up, there are approximately 1.3 million rural families in Ceylon. Their chief occupation is agriculture, while even the non-agricultural families engaged in some form of agriculture. Hence, all 1.3 million families would be potential customers of a credit system. Paddy cultivation is the mainstay of the rural economy. The average family owns only a very small extent of land. The income and consequently the standard of living is very low.

25. Preface to *Economic survey of Kurunegala District*, 1940.

CHAPTER III

Rural Indebtedness

Rural indebtedness is popularly believed to be an unmixed evil. Despite the fact that industry and commerce have expanded and are being run by the increasing use of credit, the debts of rural farmers have been traditionally frowned upon. At the outset it is necessary to make the point that there is nothing basically evil about rural indebtedness itself. As stated in a recent study, "If credit is essential to the conduct of progressive agriculture, in such agriculture as opposed to static subsistence farming, the amount of a farmer's debt at any particular time may be an indication of prosperity and efficiency rather than of poverty and financial difficulties. It is only debt which has ceased to be productive that is dangerous."[1] What has really given it a bad name is that shortage of credit and market imperfections resulting in high rates of interest have tended to make debts so uneconomic that the farmer, due to inability to repay out of income, has fallen into a state of chronic indebtedness in certain countries. Such instances together with historical evidence of chronic indebtedness in some of the European peasantries have led to the belief that invariably there is a heavy burden of rural indebtedness in every underdeveloped country. This chapter will be devoted to examining the extent and nature of rural indebtedness in Ceylon.

The data available

There is little historical information about rural indebtedness in Ceylon. There were a series of village surveys conducted, under the supervision of the Economic Adviser to the Government, between 1936 and 1948. The purpose of these surveys was to collect data pertaining to the income, expenditure, property, debt and other social and economic conditions of the villages. The selection of the villages was on the basis of a stratified random sample. In each district a number of villages forming not less than one per cent of the total was selected at random. Even if the question whether one per cent of the villages provides an adequately representative sample of rural Ceylon is ignored, there are certain other grave defects in

1. F.A.O. *Agricultural credit for small farmers*, p. 3.

the data. First, only eleven out of the twenty districts were eventually surveyed before the whole scheme was abandoned in 1948. Secondly, the surveys were conducted in different districts at different times during the period 1936 to 1948. The spread was far too wide especially in view of the fact that the period fell into three distinct economic phases, namely, the post-depression recovery up to 1939, the war-boom years between 1939 and 1945 and the post-war inflationary period after 1945. Doubtless all these varying economic conditions have had their repercussions on the rural economy. The facts revealed by such widely spaced-out surveys would show widely differing results. There is no basis for aggregating the data of all the surveys and, consequently a selection has to be made. For the purposes of this chapter, seven surveys conducted between 1936 and 1940 are selected.[2] The data are not used as a representative sample for the entire rural sector. They are used only as a rough indicator of the pre-war position not because they provide an adequate sample but because they are the only data available.

In 1950, the Department of Census and Statistics carried out a sample survey of the entire rural sector. Reference to this survey has already been made in Chapter II. The field work was carried out from October 1950 to April 1951. A stratified sample was used but the selection of villages was not done on a random basis. The selection of villages was entrusted to Divisional Revenue Officers who had to select typical villages representing their respective divisions. There were 108 villages selected to represent the various Divisional Revenue Officers' divisions. This method of selection of villages may have introduced a certain amount of sampling bias because the officials may have wished either to exhibit their best villages or to reveal the worst conditions prevailing in their divisions. Apart from this, the report of the survey itself pointed out three possible sources of error. First, the people surveyed were unsophisticated villagers who were not always able to give correct information. Second, the data being of varying degrees of complexity, cannot be said to be uniformly accurate. However, the report claimed a high degree of accuracy for the data on indebtedness. Third, the personal bias of investigators could have led to error. In addition, there is the possibility that some people, fearing damage to their

2. In all, eight surveys were conducted in the pre-war period but one of them pertaining to Kalutara District was in the nature of a pilot survey. *The Report on the Economic Survey of seven villages in the Rayigam Korale of Kalutara District* did not give as comprehensive data on indebedtness as the reports of subsequent surveys. Hence this particular survey is not selected. Those selected are the surveys of Chilaw, Galle, Hambantota, Kurunegala, Matale, Matara and Puttalam Districts.

prestige, understated their debts while others overstated them expecting to be included in some scheme of relief. Such sources of error would be present to some extent in any kind of survey and are, therefore, of a general character. There are, however, two more specific criticisms that could be made about the survey data.

First, the timing of the survey was somewhat unfortunate especially from the point of view of gauging the extent of indebtedness. The entire survey fell within the Korean-boom period when the prices of Ceylon's major exports were uniformly high and inflationary conditions prevailed throughout the economy. During periods of high export prices village incomes are affected in two ways. On the one hand, there are greater opportunities for employment on estates and village labour is absorbed into estates for temporary employment; on the other, the general inflationary situation results in higher demand for rural products. Both these factors lead to higher village incomes. Such higher incomes may be absorbed to some extent by the higher prices of commodities bought by the villager from outside. It is not possible to say whether such relative price increases result in a net advantage to the rural sector; the additional employment certainly does. With higher incomes there would be a lowering of indebtedness both due to a smaller need to borrow because of higher liquidity and higher ability to repay existing debts. This does not necessarily mean that as incomes rise people borrow less. All that happens is that when the same individual gets a higher windfall income he would be in a position to borrow less and to repay some of his existing debts. If the boom lasts long enough the individual may settle down to a higher level of living but in the short-run he would tend to reduce his debt. Consequently, the extent of indebtedness revealed by the 1950 survey would be an under-estimate.

A second criticism of the survey data is that they show the extent of indebtedness of any family at one point of time. That would ignore the probable seasonal variation in debt, which it is important to know especially from the point of view of providing suitable credit facilities. The seasonal pattern of indebtedness of any particular family or homogenous rural area may be expected to show a trough immediately after a harvest rising to a peak immediately before the harvest. This pattern may be repeated a number of times in each year depending on the crop which each family or area cultivated. Since different families were investigated at different points of time over a six month period, the effects of such seasonal variations on the sample aggregate debts may be considered to have been ironed out, in so far as there is homogeneity of seasonal variation within the sample. However, the data do not provide any information regarding the probable seasonal variation in the extent of rural indebtedness.

To sum up the limitations of the data, the pre-war data are not fully representative of the rural sector and can provide only a rough indication of the extent and nature of rural indebtedness in that period. The 1950 survey data are not based on a truly random sample of the rural sector. They are, therefore, subject to sampling bias. Further, the period of survey was a boom period; consequently, the extent of indebtedness may be somewhat understated. The data also are inadequate to investigate seasonal variations in indebtedness. The observations made in subsequent paragraphs are all subject to these limitations.

Incidence of Indebtedness

The table below shows the number of families in debt as a percentage of the total number of families surveyed at each of the seven

TABLE I

Incidence of Rural Indebtedness

Sample	*Total no. of families*	*No. of families in debt*	*% of indebted families*
(1) Pre-war, selected villages in :			
Chilaw district	340	254	75.3
Galle district	1249	947	75.8
Hambantota district	311	180	57.9
Kurunegala district	2041	1415	69.3
Matale district	692	512	74.0
Matara district	645	382	59.2
Puttalam district	173	128	74.0
All districts	5451	3818	70.0
(2) 1950 All Ceylon	22082	6659	30.2

Sources—Calculated from (1) Ministry of Labour, Industry and Commerce, Ceylon, Bulletins Nos :—

7 Report on the economic survey of	5 villages in Chilaw	District
8 ,, ,, ,, ,, ,, ,,	5 ,, ,, Puttalam	,,
9 ,, ,, ,, ,, ,, ,,	6 ,, ,, Matale	,,
10 ,, ,, ,, ,, ,, ,,	Kurunegala	,,
11 ,, ,, ,, ,, ,, ,,	9 ,, ,, Galle	,,
12 ,, ,, ,, ,, ,, ,,	6 ,, ,, Matara	,,
13 ,, ,, ,, ,, ,, ,,	5 ,, ,, Hambantota	,,

(2) Department of Census and Statistics, *Final Report on the economic survey of rural Ceylon*, 1950-51, S.P. XI of 1954.

pre-war surveys and at the 1950 survey. As already stated the pre-war data do not represent an adequate sample of the rural sector and the post-war data may be somewhat understated. However, the contrast between the periods is too marked to be explained by the limitations of the data alone.

The incidence of indebtedness in the pre-war samples ranged between 57.9 per cent in Hambantota district to 75.8 per cent in Galle district. The average for the seven districts was 70 per cent. The position as shown by a more representative sample in 1950-51 is that the proportion of indebted families has fallen to 30.2 per cent. The contrast is even more pronounced in view of the following comments made in 1934[3]:—"We have heard appalling stories of the indebtedness of the agriculturist. In districts such as Negombo and Chilaw 90 per cent of coconut planters are said to be in debt, the total amount of debt exceeding the present value of their lands. In southern areas the proportion of debt is said to be 50 per cent. In the Eastern Province paddy land is said to be fast going into the hands of the Moor moneylenders. The position in the other parts of the Island is no better."

Why has there been such a remarkable change in the incidence of rural indebtedness between the immediate pre-war period and 1950-51? No specific answer to this question can be given. There are a number of general reasons which can be adduced to show why a lower proportion of rural families should be in debt in 1950-51. First, during the war and post-war years the market for rural produce was buoyant. For instance, the price of coconut which stood at about Rs. 35 per thousand nuts pre-war rose almost continuously to Rs. 214 per thousand nuts in 1951. Paddy which was hardly considered to be an economic crop in pre-war years found a ready market at "black-market" prices, due to shortages of imported rice, during the war and immediate post-war years. Since then, Government has intervened to offer a guaranteed price scheme covering practically the whole range of rural agricultural produce. Even so, it was only over the last two years that Government has been called upon to purchase considerable quantities of paddy at the guaranteed price because open market prices were much higher until then. Of course, the prices of commodities bought by the rural sector too increased during the period but there was so little of such commodities available

3. *Report of the Ceylon Banking Commission*, 1934, Vol, 1. p. 136, S.P. XXII of 1934.

while essentials like food and textiles were rationed and distributed at controlled prices through a net-work of consumer Co-operatives. The rural sector would have had substantial liquid funds with very little to spend on. Consequently, they must have utilised their liquid resources to retire their debts and, of course, under such circumstances there was little need to borrow.

A second reason why the incidence of indebtedness could have fallen is that Ceylon enjoyed a period of full employment during the war, especially after the Japanese entry into the war. The whole economy was geared on to war-time production. The South-East Asia Command had its headquarters in Kandy and provided employment for a large number of Ceylonese. Camps and aerodromes in other parts of Ceylon offered a variety of jobs to Ceylonese.[4] The armed forces too attracted a large number of young Ceylonese who left their families in the villages; the families received additional incomes in the shape of separation allowances. Meanwhile, the estates, especially the rubber estates, worked at high pressure to produce as much as possible to help the allied war-effort. All these created substantial avenues of employment for the rural population. These additional employment opportunities at very lucrative rates of pay and allowances would have further enhanced the prosperity of the rural sector.

Thirdly, the Government colonisation and village expansion schemes, agricultural extention services, better marketing facilities, co-operatives, rural development schemes and welfare measures which made considerable headway in the war and post-war years would also have had some favourable effect on indebtedness. Educational and medical expenses have been minimised while rural development and agricultural extension services tend to make the farmer a more economic man. In general it could be said that such measures tend to make the farmer more prudent in his expenditure and to utilise his income better. Both these tendencies would lead to a reduction in debt at least for non-productive purposes.

A fourth point, which bears repetition, is that 1950-51, the period of the survey, was a particularly prosperous period throughout the economy.

4. Foreign military expenditure alone reached a peak figure of Rs. 245 million in 1942; even as late as 1950 it amounted to Rs. 32 million—vide national income estimates of the Department of Census and Statistics, and B.B. Das Gupta, *A Short Economic Survey of Ceylon*, 1949.

It is not possible to gage the precise effect on the incidence of indebtedness of any of these causes discussed above. That each of them would have had some effect cannot be doubted. The resulting incidence of 30.2 per cent can be said to be low especially in comparison to the pre-war position and the position in India where typically about 70 per cent of rural families are in debt.[5] Incidence, however, is only a first step in assessing the magnitude of the rural indebtedness problem.

Burden of Indebtedness

In Table II below the average debt per family has been expressed as a percentage of average income per family and the average value of property owned per family in respect of the pre-war surveys as well as the 1950 survey. In the pre-war surveys the average indebtedness per indebted family ranged between 29.6 per cent of average annual income per family in Kurunegala District and 89.9 per cent in Chilaw District. When all districts are taken together debt

TABLE II

Burden of Rural Indebtedness

Sample	*Av. debt per indebted family Rs.*	*Av. annual income per family Rs.*	*Av. value of property per family Rs.*	*Av. debt as % of average income*	*Av. debt as % of value of property*
(1) Pre-war, selected villages in :—					
Chilaw district	348	387	1171	89.9	29.7
Galle ,,	107	252	610	42.5	17.5
Hambantota ,,	156	288	592	54.2	26.4
Kurunegala ,,	146	493	709	29.6	20.6
Matale ,,	120	156	539	76.9	22.3
Matara ,,	118	389	665	30.3	17.7
Puttalam ,,	163	322(a)	539	50.6	30.2
All districts	145	359	674	40.4	21.5
(2) 1950-51 All Ceylon	263	1162	2765	22.6	9.5

(a) Excluding one family with an exceptional income of over Rs. 4000 per month.

Sources — Same as Table I.

5. See *All India Rural Credit Survey Report*, Vol. II. In some parts of India such as Bhagalpur in Bihar the incidence of indebtedness was as high as 91.5 per cent. Only a few villages had less than 30 per cent incidence of debt.

per indebted family was 40.4 per cent of average annual income per family. In 1950-51 the average debt per indebted family had fallen to 22.6 per cent of average annual income per family. A fall in the burden of indebtedness, measured as a percentage of average income, can take place while the average debt itself increases due to a more than proportionate rise in income. Average income per family rose from Rs. 359 in the pre-war sample to Rs. 1126 in 1950-51, or by 226 per cent; meanwhile the average debt per indebted family increased from Rs. 130 to Rs. 263, or by 102 per cent. As a result of the proportionate increase in the size of the debt lagging behind the proportionate increase in income, the burden of indebtedness has fallen. It would be interesting to draw the conclusion that as incomes increase indebtedness increases less proportionately; however, the available data is only for two points of time which were separated by a period in which a complex of causes reacted on debt as well as income. It would be dangerous to rush to any such conclusion on the basis of such inadequate material. The only possible conclusion is that the burden of rural indebtedness, as measured by the criterion used, has fallen over the period.

There is no basis for deciding what is the right percentage which debts should bear to income. In a recent study the following generalisation has been made, namely "In countries of chronic indebtedness among peasants or of heavy capital investment by more prosperous farmers the total of debt may range between one and two years' cash income, becoming a heavy burden and a serious danger in times of declining prices (because of inability to meet interest and amortisation charges and the foreclosure of mortgages) when it materially exceeds one year's income. The total of debts also often, if not normally, exceeds the liquid reserves commanded by the family in such countries at any given time".[6] The data on income available in the Ceylon samples are not separated into cash and non-cash income. Even if non-cash incomes were as high as 50 per cent of total incomes, neither in the pre-war sample nor in 1950-51 did the average debts exceed average annual cash incomes. However, the averages themselves might have concealed cases in which debts were higher than annual incomes. In the case of six

6. R. Galletti, K.D.S. Baldwin & I.O. Dina—*Nigerian cocoa farmers*, p. 513.

pre-war samples for which more detailed data are available the position was as follows :—

No. of families with debts of less than one year's income	2750	83.2%
No. of families with debts of more than one year's but less than two year's income..	269	8.1%
No. of families with debts of more than two years income	287	8.7%
Total ..	3306[7]	100.0%

Here again both cash and non-cash incomes have been taken together. Taking income as a whole, there were 536 families or 16.8 per cent of all indebted families with debts amounting to over one year's income. Judged by this criterion, there appears to have been some chronic indebtedness in the pre-war period. Comparable data are not available for 1950-51. However, it is possible to draw certain inferences from the available data. The average income per family was Rs. 1162 of which about 50 per cent or roughly Rs. 500 may be assumed as cash income. The data on size of debt[8] shows that there were only 697 family debts or 10.5 per cent of total number of debts which were over Rs. 500 each. In the pre-war sample we used total incomes; if we do the same with the 1950-51 the percentage of debts over Rs. 1162 would be substantially less than 10.5 per cent. Chronic indebtedness, as judged by this criterion, would have been confined to less than 10 per cent of the indebted families in 1950-51.

A further criterion of the burden of indebtedness would be to express the average debt as a percentage of the average value of property owned per family. This has been done in the last row of Table II. Before commenting on the results it must be stated that the valuation of rural property is subject to a wide margin of error. The report of the 1950 survey commented that "Family property generally consists of land, livestock, household and personal goods, building and other capital assets (including savings and investments, if any). Some of them are admittedly very difficult to assess. Savings and investments are very seldom disclosed in full. A margin of error is thus inevitable".[9] These comments would apply probably with

7. Excluding villages in the Matale district for which similar data were not published.
8. See Table III of this Chapter.
9. op. cit. p. 42.

even greater force to the pre-war data. There is probably an element of under-valuation in rural property because some assets would not be fully disclosed. On the other hand, the valuation of rural housing, which has little or no marketable or rental value, may introduce an element of over-valuation. The data on the value of assets are, therefore, not very reliable.

The results, as revealed by Table II, are that the average debt per indebted family as a percentage of average value of property owned per family in the pre-war samples ranged between 17.5 per cent in Galle District and 30.2 per cent in Puttalam District, the average for all districts being 21.5 per cent. In 1950-51 the proportion had dropped to 9.5 per cent.

It is not possible to state from any absolute standpoint what particular proportion debts should bear to annual income or the value of the property of the debtors. The income of the debtor enables him to meet the amortisation, interest and other charges on the debts. These can be met only if the debtor can save a sufficient margin for them out of current income, i.e., he must have an excess of current income. There were a number of deficit families as shown below:—

Sample	*% of families with excess of expenditure over income*
(1) *Pre-war Surveys* —	
Chilaw district	59
Galle „	55
Hambantota „	47
Kurunegala „	44
Matale „	53
Matara „	33
Puttalam „	61
All districts	48
(2) All-Ceylon sample	33

The pre-war income and expenditure pattern of a number of families, ranging from 33 per cent of all families in Galle district to 61 per cent in the Puttalam district, did not enable them to repay any of their debts. On the contrary, during the year they would have had to dis-save or accumulate debts to balance their family budgets. The over-all position in respect of all districts was that 48 per cent of the families had a deficit of income. In 1950-51 too there were

33 per cent of the families surveyed whose expenditure exceeded income. Such families, apart from being able to meet their debt charges, would have had to incur further debts for their continued survival; what is more, this was the position in a boom year. The report of the 1950 survey takes pride in this position and claims, "Families with excess of income over expenditure predominate in rural Ceylon ... This is in striking contrast to pre-war conditions when few families were able to balance their budgets".[10] That the position has improved since the pre-war period cannot be denied. At the same time, 33 per cent of the families, in 1950-51, had a short-fall of income while 30·2 per cent, of the families were indebted; in the pre-war samples 48 per cent of the families had a short-fall of income while 70 per cent of the families were indebted. The deficit families in one period may not be the same families which have accumulated debts as well. Nevertheless, the situation in the pre-war samples of a lower percentage of deficit families than indebted families was more conducive towards a reduction in the then existing incidence of indebtedness than was the position in 1950-51 when, apart from the existing indebted families, a further 3 per cent at least of the families were on the brink of indebtedness and were actually dis-saving. It is not suggested that this is a bad thing by itself for the dis-saving might have been for very necessary purposes. The only point of relevance is that complacency about the 1950-51 position is not completely justified because it contained the seeds of a higher incidence of debt in the future.

The amount of annual income which a debtor has is a first line of defence against chronic indebtedness. In 1950-51, 67 per cent of the families had an excess of income over expenditure. The other 33 per cent of the families had an excess of expenditure over income and would, therefore, have not been able to meet their debt charges. The sample as a whole was saving, in 1950-51, at the average annual rate of Rs. 3·3 million whereas its total debt amounted to only Rs. 1·8 million. On the average, the sample could afford to repay the entire debt out of savings over the year. However, this saving figure works out to 12·6 per cent of income which may have been possible in that boom year. Such high rates of saving cannot be expected in a normal year. Thus for instance, an island-wide

10. op. cit. p. 42.

sample revealed, in 1953, that saving amounted to only 4 per cent of income and that spending units earning below Rs. 200 per month were spending more than their earnings[11]. Although the position in 1950-51 was satisfactory the same situation cannot be expected in a normal year.

The second line of defence to meet debt commitments is property. As seen in a foregoing paragraph the value of assets was approximately ten times the average debt of the family. All this data is in terms of averages and do not bring out the conditions of sub-average families which might have been considerably worse off than the average family. All that can be said about the burden of debt, as shown by the 1950-51 data is that, on the average, the debts of families were well within their ability to meet the debt charges. Moreover, not all loans would be a charge on a single year's income as some of them would be repaid over a longer period of time. The sample as a whole would have been able to meet its entire outstanding debt out of its annual savings. However, self-sufficiency within the sample does not mean that individual members too were self-sufficient. Thirty-three per cent of the families were unable to save, and in fact were dis-saving during the period under review.

The size of debt

In Table III below debts are classified by size into four groups. The average size of debt has almost doubled between the pre-war

TABLE III

Size of debt.

Size	*No. of families in debt Pre-war, villages in 7 districts* No.	*% of total*	1950-51 *All Ceylon rural sample* No.	*% of total*
Below Rs. 50	2357	61.7	2360	35.4
Rs. 50 to Rs. 100	521	13.6	1151	17.3
Rs. 100 to Rs. 500	758	19.9	2451	36.8
Over Rs. 500	182	4.8	697	10.5
	3818	100.0	6659	100.0
Average debt per family	Rs. 145		Rs. 263	

Sources — Same as Table I.

11. Central Bank of Ceylon, *Survey of Ceylon's consumer finances*, Table 36.

period and 1950-51. This was but to be expected for the purchasing power of the Rupee has fallen to less than half during the period. According to an "implied price index," calculated by working through national income at constant prices, the price index, with 1948 as base year, rose from 33 in 1938 to 118 and 130 in 1950 and 1951 respectively[12]. With this drastic fall in the value of the Rupee, the loans required for any purpose would tend to get larger. Hence, the increase in the average size of loan is probably more apparent than real.

The available data do not enable us to say whether the size of debt was correlated with the level of income. In the pre-war data 61 per cent of the debts were in the below Rs. 50 class; in 1950-51 only 35 per cent were in this class. The general size pattern has shifted upwards, no doubt, due to the lower purchasing power of money.

Purpose of loans

The original purposes for which the debts had been incurred are shown in Table IV. The purchase, lease and development of land, the buying of cattle and cultivation may be classified as strictly agricultural purposes. Between them they accounted for 13.9 per cent of the pre-war debt and 17.1 per cent of the debts in 1950-51. Some part of the unclassified debts in the pre-war data may have been incurred for agricultural purposes. Hence it is not possible to say whether a greater proportion of the post-war debts has been incurred for agricultural purposes. Items 1 to 6 in the table may be considered as debts incurred directly in the production of all rural produce. In the pre-war data these items comprised 37.6 per cent of the total debt, in 1950-51 they accounted for 35.7 per cent of the total debt. Both these figures are somewhat under-stated since a part of the unclassified debts would have been for productive purposes. In the 1950-51 data, the unclassified debt has been further divided into productive and non-productive, although the definition may have been somewhat elastic. No such differentiation is available for the

12. W. Rasaputram, "Gross national product of Ceylon at constant (1948) prices". *Central Bank of Ceylon Bulletin, January* 1956. In this article the component parts of the gross national product estimate were deflated by appropriate indices. The results for each year were aggregated to form the g.n.p. at constant (1948) prices. The "implied price index" was obtained by dividing g.n.p. at current prices by g.n.p. at constant prices.

pre-war data. If the known un-productive items, ancestral debts and litigation, are deducted from the pre-war data and the balance of the

TABLE IV

Purpose of Loans

Purpose	*Pre-war villages in 7 districts* Amount (Rs.)	% of total debt	*1950-51 sample* Amount (Rs.)	% of total debt
1. Purchase, lease and development of land	77031	13.9	162997	9.3
2. Buying cattle	n.s.c.	—	17328	1.0
3. Cultivation	n.s.c.	—	118516	6.8
4. Trade	130991	23.7	150854	8.6
5. Buying carts	n.s.c.	—	38252	2.2
6. Building of houses ..	n.s.c.	—	137106	7.8
7. Purchase of food & household goods	72022	13.0	177898(*a*)	10.2
8. Medical purposes ..	52914	9.6	331200	18.9
9. Education	35689	6.5	n.s.c.	—
10. Ceremonial	30709	5.5	138055	7.9
11. Debt redemption	49950	9.0	91423	5.2
12. Unclassified — Productive ..	103684(*b*)	18.8	308736	17.6
Unproductive ..			78046	4.5
Total ..	553170	100.0	1750412	100·0

n.s.c. — not separately classified.
(*a*) — only food.
(*b*) — not separately classified into productive and unproductive, includes Rs. 5554 of ancestral debt and Rs. 70659 for litigation.

Sources — Same as Table. I.

unclassified debt is treated as productive, there would be a roughly comparable figure of pre-war unclassified productive debt. The total debts for productive purposes would then comprise 42.6 per cent and 53.3 per cent of the total debt in the pre-war and 1950-51 samples respectively. These figures suggest that there has been a shift towards borrowing for productive purposes. The position in 1950-51 was indeed a far cry from the alleged position in 1910, when it was categorically stated that the villagers do not borrow for productive purposes but only for weddings and funerals.[13]

13. *Agricultural Banks*, p. 3. (S. P. VIII of 1910).

Purchase of food and household goods, medical purposes and education are in the category of necessary though unproductive purposes. A well-fed, physically fit and educated rural population would enhance rural productivity substantially. At the same time such expenditure is strictly non-productive. Together they accounted for 29.1 per cent of total debts in both samples. In the 1950-51 figures debts incurred for educational purposes and for the purchase of household goods have been included under unclassified debts, hence the total would be higher and would have accounted for more than 29.1 per cent of the debt. Individually the proportion of debts for medical purposes has almost doubled.

The debts incurred for ceremonial purposes and the unclassified non-productive debt could be reckoned as the total of unproductive debts. In the pre-war sample they consisted of ceremonial, ancestral debts and litigation and accounted for 19.3 per cent of total debts. In 1950-51, the total amounted to only 12.4 per cent. This overall fall in debts for unproductive purposes is encouraging. But, there has been an increase in debts for ceremonial purposes. Apart from this the overall pattern is favourable because there has been a marked fall in the proportion of debts for non-productive purposes.

The remaining item is debt redemption. It stands half way between productive and non-productive purposes. In so far as existing indebtedness is a drag on efficiency and inhibits future development, its redemption through borrowing on easier terms would be a distinct contribution to productivity. Where, however, debt redemption indicates the mere substitution of one creditor for another on the same terms, it only helps the debtor to postpone re-payment. The proportion of debts for this purpose has declined from 7.9 to 5.2 per cent of total debts during the period.

The list of purposes for which debts have been incurred is an indicator of the causes of rural indebtedness. The farmer, like his counterpart in the city, has to incur debts for purposes connected with his process of production. His income, especially from agriculture, is received in discontinuous stocks while some of his expenditure for production constitutes a continuous flow. Even where such expenditure is discontinuous they may not coincide with the time at which he receives his income. The expenditure may also be such that it requires financing over a long period of time. The general purposes why a farmer needs credit have already been discussed in a previous chapter. One of the important causes of rural indebtedness in Ceylon appears to be the needs of the rural sector for productive capital. As we have already seen 53.3 per cent of all outstanding debts in 1950-51 was for such purposes.

Table IV also shows that the purchase of food and medical requirements, especially the latter, accounted for a substantial proportion of debts. Those incurred for the purchase of food arise due to the same cause as productive debts, namely the continuous need for food either for the family or for the labourers or for both before discontinuous doses of income are received. The high percentage of debts for medical purposes is somewhat surprising because medical attention is granted free by the Government.Presumably some rural families do not avail themselves of the free medical facilities available. The more likely reason is that because Government hospitals are situated at a distance from some rural areas, although medical attention itself is free, the costs of transport to the hospitals result in heavy expenditure for some families. Further, the villagers rely to some extent on the indigenous physicians whose services are not normally free. Such expenditure, outside the Government medical facilities, appear to be a potent cause of rural indebtedness accounting for as much as 18.9 per cent of the total debt in 1950-51.

Ceremonial expenditure also accounted for a fair proportion of total debts in 1950-51, although it was nowhere close to what popular belief would have us imagine. For the sample as a whole it cannot be said to be a very important cause of indebtedness but it is significant that debts for ceremonial purposes accounted for a higher percentage of the total debt than cultivation or building of houses. If the percentage of debts incurred for different purposes is a proper guide to priorities in rural borrowing, ceremonial expenditure holds fifth place after medical requirements, purchase of food, purchase, lease and development of land, and trade.

One other important cause of indebtedness in the pre-war sample, namely, litigation which accounted for about 13 per cent of total pre-war debts appears to have dwindled into insignificance. The rural cultivator is traditionally supposed to be a notorious litigant. The 1950-51 figures do not indicate that he gets heavily into debt as a result. Even if all the unclassified non-productive debts were taken for purposes of litigation, such debts would have accounted for only 4·5 per cent of the total. The actual figure would have been much less as there is no basis for assuming that all such debts were for purposes of litigation. If the villager was as notorious a litigant as he is said to be and as the pre-war figures seem to indicate, he appears to have overcome such tendencies in the post-war period, or at least he finances such expensive habits out of liquid resources and does not borrow for the purpose.

To sum up, the more important causes of indebtedness appear to be connected with the processes of rural production. The purchase of food, presumably between harvests, and medical expenses cause a high proportion of indebtedness. Ceremonial purposes, though not very important as popularly believed, contribute a fair proportion of rural indebtedness. Litigation, contrary to popular belief, does not appear to be an important cause of rural indebtedness.

Rate of Interest on Loans

The table below shows the debts classified according to the rate of interest payable. The most striking feature revealed by this data

TABLE V

Rates of interest on loans

	Pre-war, all districts		1950-51, *All Ceylon rural sample*	
	Amount (*Rs.*)	%	*Amount* (*Rs.*)	%
Interest free and under 6% ..	164,190	29.7	63,200	3.6
6% to 12%	97,803	17.7	538,743	30.8
12% to 18%	63,363	11.4	294,348	16.8
Over 18%	72,366	13.1	245,989	14.1
Usufructuary & other arrangements	155,448	28.1	608,132	34.7
	553,170	100.0	1,750,412	100.0

Source — Same as Table I.

is the marked fall in the proportion of debts bearing no interest and rates under 6 per cent. The fall in this category of debts has led to increases in all the other categories but is most marked in the 6% to 12% category. At first sight it would appear as though the cost of rural credit has gone up in the post-war period. However, a closer examination of the contents of the "Interest free and under 6 per cent" category shows that such a conclusion is not warranted, for this interest category has been described in the 1950-51 Survey Report[14] as follows :—"Among the loans below 6 per cent interest are also included interest-free loans. These are generally given by boutiques to their customers against purchases. The price charged for the goods often more than compensates for the withholding of interest. Again the principal of the loan bearing low interest is often fictitiously inflated in the bond, the borrower agreeing to repay a bigger amount than he actually borrows. All these concealed charges do not of course appear in the figures shown". When such concealed charges are taken into account these low interest loans would become high interest ones. Hence the mere shift away from this category into the higher interest brackets does not necessarily mean that the rural rates of interests have gone up.

Why then has this marked shift taken place? Most probably because in a period of high liquidity the normal boutique loans become unnecessary because ready cash would procure goods at low prices. In a period in which the rural sector had such liquid funds, as was the case in 1950-51, credit from the boutique keeper would have been unnecessary. In a normal year the boutique debts are likely to regain their importance especially because the Rural Co-operative Retail Stores do not sell their goods on credit terms.

The rest of the table shows that, even in 1950-51, as much as 30.9 per cent of the outstanding debts had been incurred at rates of interest higher than 12 per cent; in fact, 14.1 per cent of the debts were at rates of interest higher than 18 per cent. In the pre-war sample debts at rates over 12% accounted for 24.5 per cent of the total. The increase in this class too has been at the expense of the interest-free and under 6 per cent class. This shift, as we have argued, was not necessarily due to a rise in the cost of credit. That an increasing percentage of indebtedness was incurred in post-war years at rates of interest substantially higher than 12 per cent goes to show that the cost of credit was still high. This point is especially significant in relation to rates of interest prevailing in the commercial sector at about that time. The table below shows some representative rates of interest. The maximum rate of interest charged by commercial

14. op. cit. p. 46.

banks was 8 per cent. That a substantial proportion of debts in the rural sector was at rates over 12 per cent would go to show that there was a comparative shortage of supply of credit to the rural sector.

This point is further strengthened by the fact that as much as 34·7 per cent of the debt was under usufructuary and other arrangements. One of the rural economic survey reports[15] commented that "Usufructuary mortgage loans seem to cost the villager even a higher rate of interest. In most places the mortgage value of a coconut

TABLE VI

Commercial rates of interest, 1951

Class of debt	*Rate of interest per cent. per annum*
Bank rate	$2\frac{1}{2}$
Government treasury bills	0.4
Commercial bank deposit rates:—	
3 months	$\frac{1}{4}$ to $\frac{1}{2}$
6 months	$\frac{1}{2}$
9 months	$\frac{1}{2}$ to $\frac{3}{4}$
Savings	1 to 2
Commercial bank advances :—	
Bills	$2\frac{1}{2}$ to 6
Loans and overdrafts secured by :—	
Government securities	$2\frac{1}{4}$ to 5
Shares of joint stock coys	4 to 6
Stock in trade	3 to 8
Immovable property	$4\frac{1}{2}$ to 7
Others and unsecured	3 to 8

Source — Central Bank of Ceylon Bulletins.

tree is 50 cents. At the rate of 50 nuts per tree per annum and on the basis of a price of Rs. 10 per 1,000 nuts, the gross interest on the mortgage is 100 per cent." That was pre-war. Since then the mortgage value of a coconut tree as well as the price of coconuts have increased. Under this system, in a period of rising prices, yield remaining constant, the rate of interest on existing loans automatically goes up and in a period of falling prices it falls. In some cases the debtor remains on the property as a share cropper. In other cases the creditor takes effective possession of the property and cultivates

15. op. cit. Bulletin No. 10, p. 32.

it himself. In either case the effective rate of interest is likely to be even higher than 18 per cent, especially because only about half the value of the property would be given as a loan. The fact that it is widely prevalent strengthens the contention that all is not well with the supply of credit to the rural sector. If all the usufructuary mortgages are also classified as bearing rates of interest over 12 per cent the debts bearing rates of interest over 12 per cent work out to 65.1 per cent of the total debt.

Security for loans

The table below shows the type of security on which the loans

TABLE VII

Type of security for loans

Type of security	*Pre-war, villages in 7 districts* Amount (*Rs.*)	% of total	*1950-51 All-Ceylon rural sample* Amount (*Rs.*)	% of total
Mortgages	325724	58.9	643016	36.7
Pawns	15666	2.8	102093	5.8
Promissory notes	72187	13.1	230601	13.2
Boutiques & other unsecured	139593	25.2	472448	27.0
Usufructuary mortgage	n.s.c.	—	302254	17.3
Total	553170	100.0	1750412	100.0

n.s.c. — not separately classified; presumably included in mortgages.

Source — Same as Table I.

had been taken. In the pre-war data usufructuary mortgages were not separately classified and would have been included under mortgages. If the 1950-51 data are also similarly aggregated, the total under mortgages would be 54·0 per cent of total debts. The pattern has changed very little during the two periods. There has been a very small shift towards pawns and promissory notes from mortgages and unsecured debts. If separate data for usufructuary mortgages were available for the pre-war samples, a complete comparison would have been possible. Apparently the pattern of borrowing, in so far as security for loans is concerned, has changed very little over the period.

The mortgage continues to be the predominant form in which loans are taken. It accounted for as much as 54·0 per cent of total debts in 1950-51. Of the two forms of mortgages, the straightforward ordinary mortgage is more popular than the usufructuary mortgage, although the latter by itself accounted for 17·3 per cent of debts in 1950-51. Debts without any security from boutiques and elsewhere accounted for 27·0 per cent of debts. Possibly the share from boutiques was small, as was seen in the section on interest rates. Promissory notes accounted for 13·2 per cent and pawns for 5·8 per cent of the debts. Not much can be said about the general pattern except that the usufructuary mortgage, which is not a very satisfactory arrangement, accounted for a high proportion of the debts.

Period of Debts

There were no data pertaining to period of loans either in the reports of the pre-war surveys or of the 1950-51 survey. Consequently, it is necessary to infer from other data whatever little information possible about the period of loans. The data on security for loans shown in Table V is useful in this connection. The mortgages would be for long periods, the pawns for short periods[16]. It is not possible to be definite about the other categories, except that they would not be for long period. On this basis the period of loans would be as follows:—

	Pre-war, villages in 7 *districts*		1950-51 *All Ceylon rural sample*	
	Amount (Rs.)	%	*Amount (Rs.)*	%
Short term	15666	2.8	102093	5.8
Short and medium term ..	211780	38.3	703049	30.2
Long term	325724	58.9	945270	54.0
	553170	100.0	1750412	100.0

Now, the period of loan is intimately connnected with the purpose of loans. In the classification of purpose in Table IV, the amounts which may justifiably have been borrowed for long periods in respect of 1950-51 data, would be as follows :—

	Amount (Rs.)	*% of total*
Purchase, lease & development of land	162997	9.3
Building of houses	137106	7.8
Debt-redemption	91423	5.2
	391526	22.3

16. The period within which a pawn has to be redeemed is 12 months and seven days.

The fact that as high as 54·0 per cent of the debt was for long periods shows that more than half of those long period debts have been incurred for short or medium term purposes. That would be an unsatisfactory feature in the rural debt picture.

The Aggregate Rural Debt

The discussion, so far, has been based on samples and no attempt was made to estimate the aggregate indebtedness of the entire rural sector. The pre-war surveys do not provide an adequate sample for the purpose. The 1950-51 survey, as was argued earlier, has its weaknesses in this respect. Nevertheless, it was an All-Ceylon sample and there can be less objection to a national estimate based on its data. The only basis available for inflating the sample data to national proportions is population. Taking the total indebtedness of the sample, it can be multiplied by the ratio of the national rural population to the population of the sample. We have to use for the purpose the mid-year estimates of population published in the *Statistical Abstract of Ceylon* on the assumption that the same percentage of the population lived in rural Ceylon in 1950-51 as at the Census of 1946. On these assumptions, the estimate of the aggregate rural debt of Ceylon would be as follows :—

Total estimated population of Ceylon in 1950	7,544,000
Total estimated population of Ceylon in 1951	7,742,000
Average estimated population of Ceylon in 1950-51 (i.e. about Dec. 1950 or midway during the survey).	7,643,000
Percentage of rural population in 1946	71.9
Rural population in 1950-51 on the assumption that 1946 pattern still remained unchanged	$\frac{71.9}{100} \times 7,643,000$
Population of sample	101,793
Total debt of sample	Rs. 1,750,412
Therefore, aggregate rural debt of Ceylon	$\frac{\text{Rs. } 1750412}{101793} \times \frac{71.9}{100} \times 7643000$
	= Rs. 94,496,270

There is no data on aggregate rural indebtedness for any earlier date. Therefore, no comparisons can be made. As a percentage of rural income, the debt, as was shown earlier, was 22.6 per cent.

Sources of Credit

Neither the pre-war surveys nor the 1950-51 survey collected any data on the sources of debt. This was an unfortunate omission. Consequently, we are forced to come to whatever inferences we can from the available data. This too is possible only in respect of the 1950-51 data as the pre-war data are an inadequate sample for comparison with All-Ceylon data of certain lending institutions. We have, therefore, to work with the 1950-51 data only.

The average debt outstanding from Co-operative Credit Societies with unlimited liability, which are the rural credit societies, about this period was approximately Rs. 3.75 million. In addition approximately Rs. 3.25 million was outstanding from Co-operative Agricultural Production and Sales Societies.[17] The total outstanding debt of the rural sector to Co-operative Societies at or about December 1950 was, therefore, approximately Rs. 7 million, or 7.4 per cent of the total rural debt.

This information can lead us to a further inference; Table VII showed that the total debts without security from boutiques and other sources was 27.0 per cent of the total debt. Loans from Co-operative Societies are given without security. If, therefore, the entire debt to the Co-operatives is subtracted, the debts without security from boutiques and sources other than Co-operatives would be 19.6 per cent of the total debt. These other sources would consist of boutique keepers, moneylenders and landlords. Further, Table V on interest rates, enabled us to divide the total debt into debts at interest rates higher than 12 per cent and those at rates below 12 per cent. The debts at rates below 12 per cent interest accounted for 34.4 per cent of the total. The Government sponsored credit institutions and the Co-operatives charge rates of interest below 12 per cent; thus, all debts owing to them would fall within this class. Further, the boutique debts too would fall into this class, as they would be reckoned as interest-free debts. The boutique debt, as we have seen, is likely to be small because the total debt within the interest-free and under 6 per cent class amounted to only 3.6 per cent of the total. If we assume that the total of such debts was owing to boutiques then the composition of the below 12 per cent interest class would be as follows :—

Total debts	34.4 per cent
Owing to boutiques	3.6 per cent
Owing to Co-operatives	7.4 per cent
Owing to government sponsored credit institutions and private sources	23.4 per cent

17. Calculated from the *Administration reports on the working of Co-operative Societies* 1949-50 *and* 1950-51.

The Government sponsored credit institutions, namely, the State Mortgage Bank and the Agricultural and Industrial Credit Corporation lend only on first class security of immovable property and they also lend for purposes other than agriculture like industry and housing. The total outstanding from these two institutions about this period was approximately Rs. 32 million for all purposes. How much of agricultural debt was outstanding and how much of it was from the rural sector is not known. The proportion owing from the rural sector to these two institutions is likely to be small for reasons which will be explained in Chapter VII. As a consequence, the bulk of the 23.4 per cent of loans falling in the under 12 per cent interest class would also be from private sources. The over 12 per cent interest class would be entirely from private sources, as no part of the institutional credit system lends at rates over 12 per cent. The usufructuary mortgages are likely to be taken from landlords or non-professional village moneylenders as such loans result in the creditor obtaining a working interest in the property.

The few inferences we can draw from the available data lead us to the following rough classification :—

Debts from boutiques — less than or equal to	3.6 per cent
Debts from Co-operatives — approximately	7.4 per cent
Debts from Government sponsored credit institutions and private sources	23.4 per cent
Debts from private sources	65.6 per cent
	100.0 per cent

It is seen that private sources of credit accounted for more than 65.6 per cent; perhaps, as high as 90 per cent, of total debts. The highest proportion of debts to Government sponsored credit institutions and Co-operatives would have been under 30.8 per cent of total debts, the minimum may have been as low as 7.4 per cent. These data reveal that the rural sector is still largely financed from private sources. Co-operative societies account for as low as 7.4 per cent of total debts. This is, of course, better than in India where only 3.1 per cent of rural credit is from Co-operatives[18]. Nevertheless, there is a vast field in which Co-operatives and Government sponsored credit institutions have created little or no impression at all.

18. *All-India Rural Credit Survey*, Vol. II,

Concluding remarks on the basic features of the rural debt problem

The overall impression created by the data is that the burden of rural debt has diminished considerably as between the pre-war period and 1950-51. However, the 1950-51 data pertain to a boom period in which the need for loans would have been lower and some outstanding debts would have been settled. Consequently, if data were available for a normal year, rural debts would have been higher than and the pattern different from that revealed by the 1950-51 data. Nevertheless, the difference between the pre-war period and 1950-51 is so marked that it would still be correct to conclude that the debt position has improved in the post-war period though it may not have improved as much as was shown by the 1950-51 data.

Although the amount of debts outstanding in 1950-51 was well within the repaying capacity of the rural sector there were certain features which would have led to chronic indebtedness in individual cases. First, while only 30.2 per cent of the families were indebted, 33 per cent of the families had deficit incomes. Even though the deficit families may not be the same as those in debt the position is suggestive of an increasing incidence of debt in the future. Secondly, the rural sector as a whole was able to bear the burden of the 1950-51 debt because of an abnormal rate of savings of 12.6 per cent of income. Such rates of savings cannot be expected in normal times; 1953 data pertaining to both rural and urban families revealed a saving rate of 4 per cent only. With such a low rate of saving the rural sector cannot be expected to meet the high interest rates paid on debts. There would thus be a certain amount of chronic indebtedness. The point is that the rates of interest on 65.6 per cent of the debts was over 12 per cent and in normal times rural savings are unlikely to be large enough to meet such high interest rates while repaying the loan as well. Sooner or later the people who have contracted loans at such high rates would lapse into a state of chronic indebtedness unless repeated windfall incomes like those of 1950-51 come to their aid. Windfalls have not occurred since 1951. Meanwhile the tendencies apparent in 1951 must have worked themselves out and the rural sector in Ceylon must at present be having a larger incidence of debt as well as a larger burden of debt, some of which must be in a chronic state.

A further feature is the small share of the debt held by Co-operatives and Government sponsored credit institutions. The rural sector is financed largely from private sources and at very high rates of interest. Thus, although the overall impression created by the 1950-51 data is one of little indebtedness, the pattern of debt leaves no room for complacency. The seeds of chronic indebtedness are present in rural Ceylon ; only, in 1950-51, the climate was unfavourable for their germination. The conditions are far from being satisfactory. The basic problem of supplying credit at reasonable rates of interest to the rural sector has not been solved. The subsequent chapters will be devoted to examining the different aspects of this problem in the light of the pattern of indebtedness revealed by this chapter.

CHAPTER IV

The Demand for Credit

Rural indebtedness and the demand for credit

The mere existence of rural indebtedness, however small its incidence, is evidence of the existence of a demand for credit in the rural sector. Indeed the point needs no emphasis because farmers like any other producers need credit. However, the indebtedness data reveal the extent and pattern of indebtedness at a particular date. The normal pattern of demand may vary from the pattern of indebtedness for a number of reasons. Loans are taken for varying periods of time and the shorter period loans have a quicker turnover. Consequently, the pattern of indebtedness at any particular date may be affected by the seasonal variations in the demand for credit. The rural indebtedness data for 1950-51, as stated earlier, are inadequate in that respect in that they refer only to a particular point of time and, therefore, conceal seasonal variations. Moreover, the amount of debt at a particular date also depends on cyclical factors; the 1950-51 data were affected by the Korean boom. From a longer term point of view, the extent of indebtedness at a particular date is related to the level of development of the economy. In Ceylon rural agriculture is as yet in a semi-subsistence stage; the techniques of production are primitive and the system of production is still inhibited by traditional social relationships. Under such circumstances, the extent and pattern of indebtedness at a contemporary date can be deceptive as an indicator of the extent and pattern of demand for credit. Thus even if the seasonal and cyclical variations in the demand for credit are ignored, the 1950-51 data conceal the potential demand consistent with a rapid pace of rural economic development. Consequently, the small extent of indebtedness revealed by the data is as much a reflection of the stagnant and semi-subsistence nature of rural agriculture as of the comparatively prosperous conditions prevailing at the time. Given a rapid rate of rural economic development, the pattern of demand for credit in the rural sector is likely to be substantially different from that revealed by the data. Indeed the data showed that the strictly development purposes, i.e. purposes leading to capital formation, accounted for a very small proportion of the total debt.

Nevertheless, the indebtedness data provide a catalogue of the purposes for which credit is required in the rural sector. Those purposes which were shown in Table IV of Chapter III can all, but one, be fitted into the general classification adopted in Chapter I. The exception is the demand for credit to settle existing indebtedness. Such a demand exists due to the fact that the loans provided by existing institutions at low interest rates are inadequate to meet the current demand for credit; consequently, farmers incur debts at high rates of interest in the first instance and go to other lenders later to convert high interest loans into low interest loans. Credit for this purpose may also be required when the farmer is pressed for repayment and cannot do so out of his current income. For various reasons, which will be examined in a later chapter, the rates of interest on a majority of rural loans are high. The farmer will find it profitable to substitute for such debts loans at low rates of interest. As long as the supply of low interest loans is inadequate, there will be a demand for loans to settle existing indebtedness. Some of the existing debts bear such high rates of interest that they are an obvious barrier to rural economic development; when the payment of interest absorbs the bulk of a farmer's income his incentive to adopt improvements will be lower and his ability to do so much less due to the small amount of his net income. Consequently the settlement of the existing burden of uneconomic debts should be an essential aspect of rural economic development in Ceylon, as in some other underdeveloped countries. That cannot be done only by legal measures to control the activities of money lenders such as restricting their rates of interest because, useful as such measures may be, they do not tackle the root cause of the problem. The farmer goes to the private money lender because, in most cases, that is the only source of credit available. The money lender charges high rates partly because he enjoys monopolistic privileges and partly because, due to the overall scarcity of capital in the economy, his costs are high and he takes very big risks in lending to small farmers.[1] No amount of legal restriction on the activities of money

1. These problems will be discussed in greater detail in subsequent chapters.

lenders can solve this problem which arises out of a fundamental shortage of credit. It can be solved only by making good the deficiency in the supply of credit. Thus, the existence of high interest rate debts raises two problems. First, there will be a demand for low interest loans to settle existing uneconomic debts. Secondly, there will be a continuing demand for credit for different purposes which must be met with supply at low rates of interest in order to prevent the farmers getting into the debt of high cost lenders. It is this second aspect which constitutes a recurring demand for credit.

The rural indebtedness data also throw some light on the borrowing habits of the rural sector. The predominance of mortgage debts, accounting for 54 per cent of total debts, suggests that there is a widespread demand for long-term loans. This does not mean that in any given year 54 per cent of the demand for loans would be for long-term loans. On the contrary, the bulk of loans demanded is likely to be for short periods. This is one of the instances in which the pattern of debt is very deceptive as an indicator of the pattern of demand because a residual figure of debt would normally have a long-term bias because short-term loans have a quicker turnover. Despite that, the debt pattern illustrates the popularity of the usufructuary mortgage in the rural areas. The usual arrangement under a usufructuary mortgage is for the borrower to mortgage his property to the lender and to continue to cultivate on the *ande system*[2] whereby he turns over to the lender an agreed share, usually half, of the gross yield in lieu of money interest. Consequently, the rate of interest on the loan is not fixed and the interest is paid in kind. There are certain advantages in this system from the point of view of a borrower. The fact that the rate of interest is directly proportional to the gross yield is important and suits the peculiar hazards of agricultural production. The lender, by tacitly agreeing to share the risks of production of the borrower, enables the latter to pay interest according to his ability, taking one season with another. The borrower who finds it difficult to be tied down to contract rates of interest finds in this type of loan an arrangement which guarantees that during periods of crop failure he does not have to borrow in order to meet his commitments on existing loans. Further, the fact that interest is payable in kind is also advantageous

2. See discussion of system in a later section of the chapter.

in that the lender bears a part of the price risks as well. Thus, the farmer who, due to uncertainties of yield and price cannot be tied down to prearranged money rates of interest finds a very advantageous type of loan in the usufructuary mortgage. The main disadvantage of the arrangement is that since interest payments take as much as half his gross yield, and much more of his net yield, the borrower has little income left out of which to settle the principal of the loan. Indeed this is the very advantage which the lender enjoys. The lender is usually a landlord to whom the transaction is more in the nature of a purchase of an interest in the land than a loan. He knows by experience that it is seldom that a borrower settles the loan and redeems the property. The lender gets half the gross yield, the share which a landlord gets out of his own land under the *ande system*. Thus, during the currency of the loan he enjoys the same return as a landlord and when the borrower needs a loan again the lender is able to give him some additional money and purchase the land outright from him. Having been the effective owner of the property for a length of time, during which, conditions having been favourable, he would have got a high rate of return on his money, he eventually becomes legal owner of the property. The usufructuary mortgage gives certain advantages both to the lender and the borrower. From the point of view of the latter the advantages are short term; in the long run the arrangement works to his disadvantage. Nevertheless, the short term advantages are suited to the peculiar conditions of agricultural production. The farmer can borrow without being tied down to fixed money rates of interest, which by the very nature of agricultural production it is difficult for him to agree to in advance. The arrangement if suitably adapted can be a very appropriate method of lending to small farmers.

The crucial point revealed by the rural indebtedness data is the high interest payable on a substantial part of the debt. The implications of a high rate of interest from the angle of supply of credit will be examined in the next chapter. From the point of view of the demand for credit, the fact that a substantial proportion of the debt had been actually incurred at high rates of interest suggests that the demand curve for credit in the rural sector is rather inelastic. This inelasticity may be due to several reasons. First, rural incomes in Ceylon, as stated earlier, are low. The margin available for saving out of a low income is necessarily low. The farmer is unable to put by an adequate reserve for a rainy (or more appropriately for a dry) day. In case of crop failure he finds it necessary to borrow not only to meet the costs of producing the next harvest but also for the maintenance of himself and his dependents. The need to borrow is urgent because the alternative is to live on his capital by selling his land. Consequently the farmer is forced to borrow at any cost. Secondly, where the credit is required for the purchase of essential consumer goods, the demand for credit is derived from the demand for essential consumer goods. The demand for essentials is notoriously inelastic, especially so at a mere subsistence standard of living; consequently, the demand for credit for that purpose tends to be inelastic too. Thirdly, in some transactions the rate of interest does not enter into calculation at all. In the case of purchase of goods from a boutique, for instance, the transaction is really one of selling goods. The risks of doing so is part of the business risks of the boutique keeper who charges a price consistent with the high risks of his business and any special advantages he may possess. The rate of interest when calculated is high but it is not so calculated because the return on the transaction is in the nature of a profit made by taking high business risks. Nevertheless, the risks of the transaction arise because of the credit element in it; a large part of the profit consists of interest on credit. It tends to be high but it is concealed. A fourth reason for the inelasticity of demand for credit in the rural sector arises due to the ignorance of the borrowers themselves. As a result of these several reasons the demand for credit in the rural sector is inelastic over a wide range of transactions.

Credit needs of individual farmers

The available data is inadequate for making an estimate of the total annual demand for credit in the rural sector. In 1955, the average size of loan per member, both borrowing and non-borrowing members included, of Rural Credit Societies was Rs. 79.[3] Assuming that members of Rural Credit Societies are a representative sample of the rural sector which, as estimated earlier, consists of about

3. *Administration report on the working of Co-operative Societies*, Ceylon, 1955.

1.3 million families, the total demand for credit in 1955 would have been about Rs. 103 million. This would represent the demand for short-term credit only because the Societies give only short-term loans. There is no data on which to hazard even such a rough estimate for the medium and long-term loans. The attempt at an estimate of annual demand for credit in the rural sector must, therefore, be abandoned at this stage; it would very likely be more than Rs. 103 million per year.

An alternative method of arriving at a rough idea of the order of demand for credit in the rural sector is to work out the financial requirements of typical small farmers. Two examples are worked out below. All the financial needs are considered although in any given period only a part of the total will constitute a demand for credit. Needless to say that the figures are very rough estimates. The examples must be taken as rough indicators of the financial needs of typical farmers rather than an accurate costing of the various farming processes. They are worked out only because, in the absence of sufficient data to estimate the total demand for credit, the figures illustrate the rough order of magnitude of the financial needs of typical farming families.

Among the export crops, coconut is selected for purposes of illustration for two reasons. First, coconut is the export crop which has the largest area of contact with the rural sector, being largely a small holders' industry. Secondly, there is rather more data available for our purpose for coconut than for other crops. The obvious representative crop for domestic agriculture is paddy and hence it is selected. In both examples the assumption that the farmer owns the land is made because the value of undeveloped land is difficult to estimate. In the Wet Zone there is little undeveloped land available while in the Dry Zone there is undeveloped Crown land available. The method of alienation of Crown land in the past has always contained a subsidy element and hence a realistic estimate of the price of an acre of undeveloped land is difficult to make. Private correspondence with knowledgeable persons suggests values ranging from Rs. 75 to even Rs. 500 or more per acre.

Example I—A family holding of 5 acres of coconut

(*a*) *Cost of opening up the 5 acres in coconut—capital cost*

The costs are based on an estimate of the cost of opening up a coconut estate of 100 acres published in the *Ceylon Coconut Quarterly, April and September*, 1951. They are, therefore, based on 1951 prices. Some of the items of cost appearing in that estimate, such as the cost of building a superintendent's bungalow, have been omitted because they are unnecessary on a small holding in which the farmer and his family reside. Certain other items, such as fencing costs, have been reduced because on a residential small holding they are unnecessary to the same extent as on a 100-acre estate. The other items have been taken on a *pro rata* basis. A coconut tree takes about seven years after planting to yield.

First year	*Rs.*
Building a house for the farmer and his family	2000
Cost of plants	395
Lining, holing, filling and planting	360
Fencing	500
Weeding, trenching, watering and other costs	500
Total ..	3755

Next six years	
Weeding	480
Cost of plants for replacement of vacancies	270
Prevention of pests and diseases	250
Manuring	800
Other expenses	200
	2000

Total capital expenditure—**Rs. 5755** (i.e. Rs. 1150 per acre).

It is presumed that the farmer and his family work outside their holding to earn the cost of their own upkeep during the first seven years. To the extent they contribute their own labour towards planting and upkeep of the holding they would be entitled to appropriate a part of the total capital cost for their upkeep.

(*b*) *Cost of production*

Estimates of the cost of production per1000 coconuts are published in the *Ceylon Statistical Abstracts* of the Department of Census and Statistics. They are compiled from returns furnished by estates. There are a number of costs included in those figures which are not relevant to the case of a small holding. Therefore, the figures below have been adjusted to suit the present case.

	Rs. per 1000 *nuts*
Wages	29.82
Manuring and control of pests and diseases	10.30
Other expenses	7.56
Total cost per 1000 nuts	47.68

(The labour required on a small holding would be supplied largely by the farmer and his family. Hence the above figure would include an imputed valued of family labour).

The yield per acre of coconut in Ceylon varies very widely; it varies between 500 to 5000 nuts per acre. The average yield in a normal year is about 2000 nuts. Assuming that our farmer gets this yield his position will be as follows:—

Yield—10000 nuts, which at average 1955 prices = Rs. 1525 to 1635.

Cost of production = Rs. 477.

Net income = Rs. 1048 to Rs. 1158 or 17½ to 20% on capital.

To sum up, the financial needs of cultivating a 5-acre coconut holding would be as follows:—

First year	Rs. 3755 (at 1951 prices)
Second to seventh year ..	Rs. 667 app. per year (at 1951 prices)
Recurrent costs of production, eighth year onwards ..	Rs. 477 per year (at 1955 price).

These figures give a rough indication of the financial needs of a 5-acre coconut holding, a part of which will result in a demand for credit. For instance, a part of the capital cost of Rs. 5755 would lead to a demand for credit. The peculiarity of the demand is that the loan will be required for a long period and the farmer cannot pay heavy service charges in the first seven years, unless he earns a sufficient income outside the holding to meet his living costs and pay the service charges as well. In the first seven years he can probably pay only interest on the loan. After the eighth year his annual income will rise because he gets an income from his holding while he can continue to work outside for most of the time, as a coconut holding does not require a regular supply of labour. Then he should be in a position to repay his loan fast. Given a series of normal years, he may be able to liquidate the entire capital sum in six to eight years. Adding the initial period of seven years the loan would be for a period of thirteen to fifteen years. Meanwhile, since coconut yields about four times a year, he would need short-term loans every three months or so of about Rs. 120 to meet costs of production.

Example II—A family holding of three acres of paddy

(*a*) *Cost of opening up the* 3 *acres of paddy—capital cost*

The approximate average cost of colonisation incurred by government in 1953 has been worked out as Rs. 3775 for a holding of 3 acres of paddy and one to two acres of highland.[4] These costs include certain subsidies which cover only part of the costs of the farmer. Again, the costs of providing certain civic amenities, necessary in a colonisation scheme, but not incurred by an individual farmer, have also been included. However, in the absence of any other estimate, this data offer some basis for estimating the costs of opening up three acres in paddy. Making some adjustment in the data, the cost of opening up three acres in paddy may be estimated as ranging between Rs. 3000 and Rs. 3500. The items of cost include the imputed cost of family labour, the cost of seed for the first sowing and the cost of a house. This is only a very approximate estimate based on 1953 prices. In the absence of more detailed data it gives a rough indication of capital costs.

(*b*) *Cost of production*

No systematic attempt has been made in the past to estimate the cost of production of paddy in Ceylon. There are no published date available. Consequently, we have to rely on personal inquiries. There are two sets of figures shown below. The first is based on figures supplied by an officer of the Food Production Department, Ceylon.[5] They are the results of personal investigations made by him in several districts of Ceylon. The costs per acre varied between Rs. 85.37 in Kuruwita and Eheliyagoda to Rs. 379.25 in Kotmale. There are very wide differences between areas. In some areas, the Japanese method of cultivation by transplanting from a nursery

4. B.H. Farmer, *Pioneer peasant colonisation in Ceylon*, p. 320.
5. I am indebted to Mr. V.T. Navaratne, Assistant Director of Agrarian Services, for very kindly supplying me the results of his own personal inquiries in several districts of Ceylon.

is being used; in others the seeds are sown broadcast. Again, in the particular season, some farmers manured their fields, others did not. There is no basis for averaging the data and, hence, the figures quoted below are for an area in which the costs were mid-way between the two extreme cases. The total cos of production in this case was Rs. 237, made up as follows:—

Cost of production per acre of paddy in Gampaha area	*Rs.*
Seed paddy	25
Buffaloes, ploughing and levelling	70
Manure and fertilisers	44
Clearing and making bunds and channels	22
Sowing	25
Transplanting	5
Harvesting	16
Threshing	30
Total ..	237

An alternative estimate is provided from another personal inquiry.[6]

Cost of production per acre of paddy in Galwadukumbura village	*Rs.*
Seed paddy—2 to 2½ bushels under ordinary method. (*a*) ..	25
Ploughing—(Each season a field is ploughed thrice. At each ploughing 2 men and 4 buffaloes are needed). (*b*)	42
Manure—Leaf manure—Rs. 50 Artificial manure—Rs. 29 (Rs. 14.50 per cwt). ..	79
Levelling—4 men and 4 buffaloes required	20
Sowing—5 men required	15
Transplanting—16 women required	32
Reaping—10 men required	30
Collecting and bringing to threshing floor—8 women required. (*c*)	16
Harvesting—7 men and 2 buffaloes required.	25
Feeding labour—at ploughing, levelling, sowing and reaping a midday meal has to be provided for the men. The women have to be given tea and betel when transplanting etc. Approximate cost of food ..	55
Total ..	339

6. I am indebted to my late father for making inquiries at my request in the Galwadukumbura village in Matale district where he resided. These estimates are shown because they give certain details of the process of production and provide a rough independent check on the other estimate.

Notes

(*a*) Where the Japanese method is used, only one bushel of seed paddy is required. However, this method is not widely used at present.

(*b*) Money wages have been calculated at the following rates:—

Man	—	Rs. 3 per day
Woman	—	Rs. 2 per day
A pair of buffaloes	—	Rs. 4 per day

In practice, money wages are rarely paid. The labour is supplied on the *attam* system, whereby each farmer pays for labour by working the number of turns in the other farmers' fields.

(*c*) The number of women required depends on the distance between the field and the threshing floor.

As against these widely varying costs of production, yields also vary. In the Galwadukumbura village, for instance, yields vary from about 30 to 50 bushels per acre. The average yield in Ceylon is about 30 bushels per acre. In certain areas double-cropping is possible; in Gampaha and the Galwadukumbura village double-cropping is the usual practice. Assuming an average yield of 30 bushels per acre and two crops per year, the following position emerges:—

Cost of production	—	about Rs. 200 to Rs. 350 per season (ignoring the very high and very low cost cases) per acre, i.e. Rs. 1200 to Rs. 2100 for the three acres per year.
Gross return	—	180 bushels at Rs. 12 per bushel = Rs. 2160.
Net return	—	Rs. 60 to Rs. 960 or about 2% to 30% on capital. (The costs and yields have been assumed to be equal in the two seasons. In practice both are liable to vary).

The actual return to the farmer and his family would be higher because they would themselves work on the field, and, therefore, economise on outside labour costs. Costs have been inflated by imputing money values to family labour at current wage rates; the opportunity cost of family labour is likely to be lower because of the absence of regular alternative opportunities for employment.

Some of them, especially the women and children, would not work outside the family holding even if alternative employment were available. The costing of farm work and the pricing of the total product are unrealistic in a semi-subsistence context. Nevertheless, the cost of production figures offer a rough indication of paddy cultivation costs of typical farmers.

To sum up, the financial needs of cultivating a 3-acre paddy holding would be somewhat as follows:—

Initial capital outlay	Rs. 3000 to Rs. 3500
Recurrent seasonal costs of production ..	Rs. 200 to Rs. 350

(ignoring the very high and very low cost cases).

Only a part of these costs will create a demand for credit. The initial capital outlay may be required on credit. Unlike the coconut cultivator, the paddy farmer, given normal weather conditions, can commence repayment from the very first season. He does not have a prolonged initial period of waiting. However, his yields are more inter-spaced. Whereas the coconut cultivator has four crops per year, the paddy farmer has at most two. In certain areas only a single crop per year is possible; the paddy cultivator, therefore, requires short-term credit for a period of six months to a whole year. In paddy cultivation, short-term credit has a slower turnover than in coconut but long-term credit can be repaid over a lesser number of years.

These two examples although they refer only to coconut and paddy provide a standard of reference for discussing the peculiarities of the demand for credit in other crops. A tea cultivator can expect some yield by the fifth year after planting. In that respect his case is like that of a coconut cultivator. The tea bush like the coconut palm yields up to about the sixtieth year and by systematic inter-planting both types of holdings can be maintained perennially. However, unlike in the case of coconut and paddy, tea yields throughout the year; in Ceylon, unlike in India, there is no winter period of rest. The tea cultivator has a yield throughout the year, and, consequently, if his marketing arrangements and prices are satisfactory, he would not be in need of short-term credit for meeting his costs of productions, and living costs of his family. His credit needs are likely to arise more for effecting permanent improvements to his property.

The case of a rubber cultivator is again similar to the case of a tea cultivator in most respects. He, like the tea and coconut cultivator, has an initial period of waiting. Rubber takes about seven years after planting to yield. Thereafter, given favourable weather conditions, a rubber tree can be tapped almost every other day. Given suitable marketing arrangements, a rubber cultivator too would not be in need of short-term credit to meet costs of production and family living costs because he has a continuous flow of cash income.

The cases discussed illustrate a salient feature in the demand for credit in the rural sector. Farming is not a homogeneous industry. There are as many types of farmers as there are crops, and individual credit needs vary very widely between different types of farmers. A credit institution operating in any particular area has, therefore, to be adapted to suit the needs arising from the kinds of crops grown in the area. For instance, in an area where paddy or coconut predominates, there is likely to be a greater demand for short-term credit than in an area where rubber or tea predominates. In the latter case the demand will be mainly for long-term credit. In the former areas there is bound to be a marked seasonal variation in the demand for credit; whereas in the latter areas the demand is likely to be steadier. The significance of the marked seasonal variation in the demand for credit in certain areas is that during certain periods, more precisely immediately after harvest time, there would be an excess of loanable funds, while during other periods there would be a comparative scarcity. It is, therefore, important that the village level organisation should have avenues for investing excess funds during slack periods and for drawing on such funds during periods of high demand.

Credit and development

As stated earlier, the existing pattern of debt and the demand for credit do not reveal the potential demand for credit under a more rapid pace of development. There are three major aspects of development in which credit has to play an essential role.

First, the techniques of production employed in Ceylon, especially in paddy cultivation, are primitive. The opinion of two Japanese experts was that "rice cultivation in Ceylon was reminiscent of the paddy cultivation practiced in Japan 50 years ago", and that average yields, which are about a third of Japan's, could be increased by about 50 to 100 per cent.[7] A similar view has been expressed in a more recent study.[8] The table below illustrates the point expressed by these experts. It is seen that the average yields in Ceylon are very low in comparison to non-Asian countries,

TABLE I

Rice yields

Region or Country	*Yield*—100 *kg. per hectare* 1934-38	1948-52	1953	1954
Europe	51.8	42.9	46.3	42.2
North America	24.7	25.7	27.7	28.3
Latin America	15.2	16.8	15.7	16.0
Africa	9.8	9.5	10.3	10.1
Oceania	38.0	31.1	34.3	—
Far East	17.7	16.3	17.2	16.5
Near East	21.0	22.6	23.1	26.4
WORLD (excluding Russia) ..	17.7	16.3	17.3	16.5
Asia	17.7	16.3	17.2	16.5
Japan	36.3	40.0	34.5	48.1
Turkey	18.8	35.2	34.2	37.8
China—22 provinces	25.3(*a*)	24.8(*b*)	24.9	—
Taiwan	24.6(*a*)	22.1(*b*)	26.3	25.2(*b*)
North Borneo	6.3(*c*)	12.6	17.5	23.0
Burma	14.1	14.1	14.0	14.8
India	13.6(*d*)	11.1	13.5	12.2
Pakistan	14.8(*d*)	13.8	14.0	13.4
CEYLON	9.9	13.0(*e*)	13.0(*e*)	13.7(*e*)

(*a*) 1931-37.
(*b*) Unofficial source.
(*c*) Average of 4 years.
(*d*) 1936-38.
(*e*) 1952-54 data not comparable with pre-war data because of change in statistical method since Maha 1951-52.

Source:—F.A.O. *Year-book of food and agricultural statistics*, 1955.

except Africa. Among Asian countries too the average yields in Ceylon are among the lowest. This may, of course, be due to difference in soil fertility and other natural factors such as the shorter duration

7. *Report on the establishment of a rice research organisation in Ceylon*, p. 7, by Dr. T. Moringa and Dr. S. Mitsui, S.P. No. XIX of 1955.
8. *Report on soil and paddy problems in Ceylon*, p. 13; prepared by J.G. Vermaat, F.A.O., Agricultural chemist. S.P. XIX of 1956.

of daylight in Ceylon. Nevertheless, it is an accepted contention that, despite any natural handicaps, the yield of paddy in Ceylon can be improved. The majority of paddy lands are only surface ploughed with the aid of wooden ploughs. In 1945, only in 933 holdings covering 4195 acres was any tractor ploughing employed.[9] The kind of ploughing done on the rest of the fields merely digs up the surface leading to inadequate aeration of the soil. There are several reasons for the prevalence of such low productive methods of cultivation. A major reason would be the very small size of average holdings in which, given a cheap supply of labour, the use of tractors and other mechanical implements of production is uneconomic. In some cases the holdings are so small that the use of some implements is physically impracticable. There is also the fact that, with the small size of holding, rural incomes are so small that they leave little margin for investing in improvements of techniques. The small size of holding and the low level of income are also inimical to experimentation. Where the farmer carries on a precarious existence at a barely subsistence level of income he is afraid to try any experiments and, therefore, sticks to the traditional methods of cultivation, which to his mind have proved successful in use over long years.

The improvement of the techniques employed by a backward peasantry is partly a matter of education. The farmer has to be made aware that his techniques are primitive and that if he adopts suitable new techniques his yields, and thereby his income, could be improved. For that purpose general education and specific extension services designed to demonstrate the feasibility of adopting new techniques are essential. Such steps are even now being taken in Ceylon. However, they can, at best, only create a desire on the part of the farmer to adopt better techniques. His ability to adopt better techniques must necessarily depend on his ability to finance them. The essential role which credit has to play in improving the techniques of production is to supply credit to finance their adoption.

A second feature of small scale agriculture in Ceylon, especially in the case of paddy, is the prevalence of systems of tenure inimical to the adoption of better techniques and efficient cultivation. Data pertaining to the systems of tenure on paddy lands are shown in Table II.

9. *Census of Ceylon*, Vol. I, Part II.

TABLE II

Asweddumized paddy lands, by status of cultivator 1945-46

Status of cultivator	*No. of holdings*	*Acreage*	*% of total acreage*
Owner	469701	495525	55.0
Lessee	28069	81917	9.1
Ande tenant (*a*)	199934	212151	23.6
Usufructuary mortgagee (*b*) ..	1832	1845	0·2
Tattumaru owner (*c*) ..	52190	58572	6.5
Others (*d*)	20182	49960	5.6
Total ..	771908	899970	100.0

(*a*) A cultivator who leases out the field for one or more seasons for payment of a share of the crop.

(*b*) A cultivator who has obtained possession of land as a mortgage and enjoys the fruits thereof in lieu of interest on the debt.

(*c*) A cultivator who is co-owner of an undivided land and cultivates the land in rotation with other co-owners.

(*d*) Others include

(i) hired cultivator—a cultivator who is hired and is paid a wage.

(ii) L.D.O. allottee—a cultivator who has been allotted land under the Land Development Ordinance.

(iii) Food production permit holder—a cultivator who has been granted permission to cultivate Crown land for food production purposes.

(iv) Cultivator of service tenure land—a cultivator of land subject to service tenures (such as temples, devales, nindagam, etc.)

(v) Cultivator for merit—cultivator of land belonging to temples, etc., done gratis in the hope of procuring merit.

(These explanatory notes are taken from relevant tables in the Report).

Source:—Census of Ceylon, Vol. I. Part II.

Fifty five per cent of the total acreage is cultivated by the owners themselves. This category would also include usufructuary mortgagors, who have not been separately classified. As stated earlier, the status of a usufructuary mortgagor is no better than that of an *ande* tenant in so far as the mortgagee enjoys the share of produce which a landlord is entitled to. However, the mortgagor would continue to cultivate the land as his own land, the mortgagee having no right to engage another tenant. In that sense the usufructuary mortgagor is an owner-cultivator. Since they too would have been included in the category of owners, the actual percentage of cultivators entitled to enjoy the full product from their lands would have been less than 55 per cent. The average size of the owner-cultivated holding is only just above an acre and is, therefore, slightly smaller than the national average of 1.2 acres. The farmer who owns the land he cultivates has an incentive to improve the productivity of the land since he is the sole beneficiary of the fruits of his efforts. Hence, from the point of view of rural economic development this form of tenure offers the best incentives.

The leasehold tenant accounts for 9.1 per cent of the total acreage. The average size of the holding is nearly 3 acres and is, therefore, almost two and a half times the national average. A lessee too will have an incentive to develop his land provided the lease is for a sufficiently long period, and gives him ample scope to enjoy the fruits of his efforts. This form of tenure, which is very popular in advanced countries like England, is satisfactory from a developmental angle.

The *ande* tenants account for 23.6 per cent of the total acreage. *Ande* tenancy is also a form of leasehold and has been popular from ancient times. The rent is paid in kind and the amount is a share of the gross yield, usually half. The actual share varies depending on whether the landlord supplies any of the costs of production, such as seed paddy, buffaloes, ploughs, etc. Normally the landlord supplies only the land, in which case he gets half the gross yield. The fact that the rent varies in direct proportion to the gross yield, and that it is payable in kind has important advantages for the tenant. Whereas under a system of fixed rents he would have to pay the rent irrespective of his yield, under the *ande* system, his rent can fall to zero in case of complete crop failure. The landlord bears the risks of production with the tenant, a very important factor in rural agriculture with all its high production risks. Then again, if the rent were a fixed money payment, the tenant would have to pay it irrespective of fluctuations in the prices of his produce. Under the *ande* system, since payment of rent is made in kind, the tenant is not adversely affected in the payment of rent by a fall in the price of the product. The landlord bears the price risks associated with a change in the money value of the rent payment in kind. Nevertheless the system is disadvantageous from the point of view of developing paddy cultivation. The landord's share being as high as fifty per cent of the gross yield, the tenant farmer who has to bear all the costs of production is left with only a very small proportion of the gross yield as his net income, i.e. the return to the tenant for his costs and labour is low.

It is interesting to inquire why the landlord has been able to obtain the services of the tenant at such a low wage. Apart from social rigidities there is the economic fact that there are few opportunities for alternative employment of village labour. In such circumstances, under a system in which the landlord is free to change his tenant every season, the tenant has no option but to accept his low wage. Of course, the fact that the *ande* system is accepted by tradition is as important as the economic reason but, given more opportunities for alternative employment the wages of tenant labour are bound to rise. Whatever the causes for the survival of the system may be, it is undesirable from a developmental angle for two chief reasons. First, it is readily seen that a larger share would bring forth a greater total output. The tenant has no incentive to adopt improvements because he gets only half the marginal increase of income. After a point his marginal costs would be higher than his net marginal revenue. This point will be reached the sooner, the smaller his share of the gross yield. At some level the adoption of better techniques, even though they yield an adequate gross marginal return, will not be economic for an *ande* tenant because he gets only a proportion of the gross return. The system is, therefore, inimical to the adoption of better techniques of production. Secondly, even if he were entitled to a larger share he would have no incentive to adopt improvements due to the insecurity of his tenure. The tenant is a share-cropper-at-will. The landlord has the legal right to change his tenant every season. In practice, however, the same tenant continues to cultivate the same land for a number of years; there are instances in which several generations of the same family have cultivated a particular paddy field. The important point, however, is that the tenant has no legal right to fixed tenancy. Since he can be removed the very next season he has no incentive to adopt improvements, which are very necessary for development.

The Paddy Lands Act No. 1 *of* 1953 made an attempt to introduce a system of fixed tenancy but it has so far been proclaimed only in two districts, namely, the Hambantota and Batticaloa districts. At the time of writing a new Paddy Lands Bill is under discussion. Its details are not yet known. It is reported to embody the twin features of a fixed rent and permanent and heritable tenancy rights. This step should increase the incentive of tenant farmers to adopt improvements. At the same time, it is likely to dry up an existing source of credit for the tenant farmer, namely, his landlord. Since the landlord will then have less of a hold on his tenant and since usufructuary mortgages will yield a lower rate of return, he will find it more risky and less remunerative to lend money to his tenants. Moreover, the long-term prospect of owning a usufructuary mortgagor's land will be diminished because the tenant will then be in a better position to repay his debts. Consequently, the supply of credit from this source must be expected to dwindle in the future. The deficiency must be made good.

Another important class of farmers consists of *tattumaru* owners. Under this system a number of co-owners cultivate a small piece of land in rotation. It is a system that has become necessary to prevent the fragmentation of holdings into minute strips arising from the custom of bequeathing ancestral property to all heirs. *Tattumaru* ownership substitutes fragmentation of ownership for fragmentation of holdings, and, in so far as it does so, it is a satisfactory system. The disadvantage lies in that each co-owner tries to extract the maximum output out of the land at his turn of cultivation while contributing the minimum of input. Obviously, the system is not conducive to the adoption of long-term improvements in the techniques of production. Even short-term improvements like the use of manure will rarely exhaust themselves in the course of one season and each co-owner is in turn likely to expect the next to do it.

The *tattumaru* system of cultivation is the result of the pressure of population on land combined with the accepted system of inheritance. With increasing population and a less than proportionate increase in the area under cultivation, the average size of holdings would fall.[10] This leads to fragmentation of holdings and sub-division of ownership; the *tattumaru* system is a device for preventing minute fragmentation but it is an unsatisfactory device because it leads to inefficient cultivation.

Attempts to tackle the problem of fragmentation generally take the form of consolidation of holdings. Such steps lead essentially to the re-organisation of the existing parcellation of land. They

10. Table VI of Chapter V shows that the pressure of population on the land has tended to reduce the extent of cultivated land per head of rural population.

do not adequately tackle the basic problem which leads to fragmentation, namely, the growth of population with a less than proportionate increase in the area under cultivation and without expanding opportunities for employment outside agriculture. If inheritance was based on primogeniture, under such circumstances, it would lead only to mass unemployment in the rural sector. It may achieve the objective of keeping holdings at a larger size but it immediately creates the problem of finding alternative employment for a large number of dispossessed persons in each generation.

The existing system provides a cushion against such unemployment by absorbing the entire rural labour supply into the land. Any system which attempts to replace the present system must, therefore, not only prevent fragmentation but also attempt to find an outlet for the excess labour thus thrown out of the land; this is a larger problem which cannot be discussed within the limits of this study. The adoption of better techniques of production may lead to more employment in the rural sector itself but, even so, the extent of fragmentation at present is such that if any attempt at remembrement is made a substantial part of the rural population will have to find jobs outside their present holdings.

This raises an important aspect of agricultural credit, namely, the need for re-capitalisation of farm holdings at each generation. In order to prevent fragmentation the family holding should pass on to the eldest or any other child interested in agriculture. If at the time of taking over a farm, the new farmer is able to buy the shares of the other heirs, it would achieve the twin objectives of preventing fragmentation and compensating the other owners, who would also have some little capital thereby to start a career elsewhere. It is necessary to provide long-term credit for this purpose.

The need to prevent fragmentation has been recognised in the colonisation schemes, where the law prevents the breaking up of the family holding of 3 acres of paddy land and 1 to 2 acres of highland. This legal requirement alone cannot prevent fragmentation. Although a holding is allotted to a single farmer-family, several members of the same family subsist and work on the holding and after some time there is bound to be effective fragmentation even though the law would recognise the claims of only a single farmer. As stated earlier the effective remedy lies in providing employment opportunities outside the family holdings. The process is likely to be facilitated by providing credit for the re-capitalisation of farms holdings at the death of each owner or at the time land passes from one owner to another.

Apart from the need to prevent fragmentation in the future there is also the need for consolidation of the existing holdings. The economic size of holding in paddy cultivation in Ceylon has never been worked out nor do we have sufficient data for the purpose. Nevertheless, any scheme of rural economic development must consider the need to increase the average size of holdings, especially in paddy. Given the employment of better techniques, and more intensive cultivation of small holdings, the size of holding which a family would require to maintain a given standard of living would be smaller than under the present techniques. However, the basic objective of rural economic development must be to achieve a progressively increasing standard of living for the rural population. For that purpose, the size of the family holding will have to increase progressively. This would take place automatically if farmers had the finances, i.e. credit, to buy up the uneconomic holdings of other farmers. It is necessary even now, it will become even more necessary as rural agriculture gradually sheds its traditional inhibitions and takes to farming on a commercial scale. It might be objected that the process can lead to a concentration of land ownership in the hands of a few large land owners. However, rural agriculture in Ceylon has a long way to go to reach such heights and, then, appropriate steps can be taken to prevent such an eventuality. The important point now is that with suitable credit facilities it will be possible to aim at a progressively increasing size of farm holding leading to higher standards of living in the rural sector.

The third sphere of development in which credit would be required is that of expansion in the area under cultivation. The improvement in the techniques and the system of tenure is likely to lead to a more intensive cultivation of the existing area under cultivation. However, with the rapid increase in population,[11] an increasing area of land will have to be brought under cultivation both to increase the food supply and to prevent further fragmentation of land and provide employment for an increasing labour force. There has been

11. Ceylon's population is increasing at an annual average rate of 2.76 per cent. It increased from 6.7 million in 1946 to 8.1 million in 1953.

no systematic survey of land–potential in Ceylon. The most optimistic estimate of the land still available for cultivation is about 3 million acres.[12]

The area under cultivation can, thus, be almost doubled. Most of the new land is available in the Dry Zone. If the future policy, as it has been in the past, is to resettle families from the Wet Zone on undeveloped land in the Dry Zone, it has implications from the point of view of credit. In the past, the Government has subsidised these settlers very heavily.[13] There is, at the moment, a certain amount of vagueness about future policy. The subsidies have been necessary in the past as an inducement to make families migrate from the Wet Zone to the Dry Zone. Then the Dry Zone was malaria-ridden and was ill-supplied with transport and communications. Since then, thanks to D.D.T., malaria has been almost completely eradicated and Government, ever since 1931, has been investing vast sums of money on providing roads, irrigation and other amenities to these areas. There is, at the moment, a greater rush to the Dry Zone colonisation schemes than the Government can cope with. Under the circumstances, it would be unnecessary to subsidise the new settlers any more, except to provide them with the initial capital.[14] That can be supplied on loan rather than as a subsidy. That, however, is a matter of policy; if such a policy is adopted it would be necessary to supply the necessary capital to the settlers on credit. The availability of credit to re-capitalise existing farms, referred to earlier, will also facilitate the process.

The role of credit in rural economic development can now be summarised. The techniques of production are admittedly inefficient. Farmers' desire to adopt new techniques will depend largely on education and extension services. Given a desire to adopt them, their ability to do so will depend on the availability of credit for the purpose. Development is also inhibited by the systems of tenure prevailing in the rural areas. The *ande* system and *tattumaru* cultivation are not conducive to the adoption of improvements. They, however, exist due to social rigidities as well as due to the logic of rural economic circumstances. The *ande* system if replaced by a

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12. S.P. XIX of 1956, op. cit.
13. See section on *Government and the small farmer* in Chapter VIII.
14. B.H. Farmer, op. cit. p. 279.

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system of fixed rents and secure tenancy will lead to the drying up of credit from the landlords. The gap must be filled. The *tattumaru* system is only a device to meet the fragmentation of holdings and the sub-division of ownership arising out of the growth of population without corresponding opportunities for employment outside the family holding. The solution lies in providing employment opportunities elsewhere. The process can be facilitated by providing credit for the re-capitalisation of farm holdings and the expansion of the area under cultivation. The latter itself raises the problem of providing capital to migrant settlers to develop the new lands. Hitherto, Government has supplied the capital on subsidy. There appears to be no more need for subsidies if the capital could be supplied on loan.

There is one problem which may be appropriately discussed here. We have so far assumed that a small farmer class will continue to exist in Ceylon. It may be argued that the best thing that can be done with small farmers is to make them labourers and convert the existing lands into large units. In fact, in tea and rubber the larger unit has proved to be more efficient. In the case of other crops there is no such clear evidence. On the contrary, in countries like Japan and Burma paddy growers are small holders. It is not within the scope of this study to judge the theoretical validity of the contention that small scale farming should be abandoned, nor is adequate evidence available for the purpose. From a practical angle, such a course of action, even if a Government can be found to support it, is bound to lead to difficulties and considerable delay. The dispossessed small farmers will be immediately seeking jobs, and jobs are hard to come by in Ceylon. The implementation of such a programme also cannot be done overnight. It is liable to take time depending on the efficiency with which it is implemented. When these practical aspects are taken into consideration, the assumption made in this study is not unreal, even if it is theoretically desirable to abandon small scale cultivation. Further, in the previous paragraphs, credit needs of farmers have been stated in relation to development, especially from the point of view of progressively enlarging the size of holdings.

CHAPTER V

The Supply of Credit

The chapter on rural indebtedness showed that as much as 65.6 per cent of rural debts, in 1950-51, carried rates of interest higher than 12 per cent per annum. These rates were in contrast to rates in the commercial sector of the economy, where the highest rate charged by commercial banks on unsecured loans was only 8 per cent per annum. There is not much evidence available about the actual rates of interest charged on individual loans.

The findings of the Kandyan Peasantry Commission[1] also tend to confirm that interest rates in the rural sector are high. The Report of a Committee appointed in 1950 to inquire into indebtedness in the Public Service quoted the following rates as those at which Government Servants obtain loans:—[2]

From Government	$1\frac{1}{2}$ per cent
Government Associations	6 to 9 per cent
Pawn Brokers	24 to 28 per cent
Professional moneylenders	120 to 300 per cent

If Government Servants have to pay such high interest rates to private lenders, the rates charged from small farmers can only be expected to be higher. All this serves to illustrate the fact that the existing supply of credit is inadequate either in quantity or quality or in both to meet the existing demand for credit in the rural small farmer sector. The rest of this chapter will attempt to answer the question why rural interest rates are high, or which is the same thing, why credit of the right type does not flow in sufficient quantities into the rural sector to bring the rates of interest into line with those prevailing in the rest of the economy.

This situation may be due to a number of causes which may be broadly classified into three groups, viz:—

(*a*) the high risks of lending;
(*b*) the high costs of lending; and
(*c*) imperfections in the rural credit market.

1. Report of the Kandyan Peasantry Commission, S.P. XVIII of 1951.
2. Report of the Committee on Indebtedness, S.P. XVII of 1951.

The high risks of lending

Lending money to agriculturists, particularly to small farmers, is generally agreed to be more risky than lending to industrialists or for commercial purposes. The high risks are due to the very nature of agricultural production, as discussed in Chapter I. In Ceylon, lending to small farmers is risky owing to:—

(*i*) the high risks of production;
(*ii*) lack of suitable security;
(*iii*) the low incomes of small farmers; and
(*iv*) the insecurity of tenure.

High risks of production

The risks of production arise from the uncertainty either of yields or of prices or of both. The uncertainty of yields is owing to the fact that agriculture in Ceylon, as elsewhere, is a biological process heavily dependent on the vagaries of nature. Despite the progress of irrigation schemes, as much as 406,412 acres or almost 50 per cent of the area sown in Maha 1954-55 was dependent on rain water. The uncertainty of rains especially in the Dry Zone has been referred to earlier. Consequently, crop failure is a frequent occurrence. In the latter part of 1955 and almost throughout 1956 there was a prolonged drought. Mainly as a result of that the yield of paddy is estimated to have fallen from 35 million bushels in 1955 to 30 million bushels in 1956, i.e. by 14.3 per cent.[3] Nor is rainfall the only natural condition affecting paddy cultivation. As the table below shows, other reasons too lead to crop failure. Even in

TABLE I

Paddy crop failure

	Maha 1954-55	*Yala* 1955
	acres	*acres*
Extent sown	824572	522252
Extent harvested	793273	492075
Extent affected by—seed failure	3232	5052
drought	5857	7820
flooding	15009	14987
pests	3541	3506
other adverse factors	2343	1597
All adverse factors (*a*)	30882	32962

(*a*) The figures are not the actual differences between the extent sown and the extent harvested as they include partial damage to the crop.

Source:—Statistical Abstract of Ceylon, 1956.

3. Central Bank of Ceylon, *Annual Report*, 1956, p. 27.

the more favourable conditions in those two seasons there were substantial acreages on which crops failed partially or completely. The table does not show the number of acreages on which no sowing at all was done. At the Census of 1946 the extent of asweddumized paddy lands was 899,970 acres. Since then there has been further extension in the area under cultivation. However, even in comparison to the 1946 acreage, the average acreage sown in Maha between 1951-52 and 1954-55 was 83 per cent of the total. The extent sown in Yala is much less; between 1952 and 1955 the average acreage sown was only 50 per cent of the total. Thus a cultivator may not be able to cultivate his paddy fields in some seasons at all and even when he does there are several adverse factors which can lead to crop failure.

Paddy yields themselves vary considerably from one season to another owing mainly to the various adverse factors listed above and from district to district and even field to field due to variations in soil fertility and climatic factors. Thus, for instance, in Yala 1955, the average yield per net acre harvested in Polonnaruwa district was 54.92 bushels and in the Puttalam/Chilaw district it was only 21.70 bushels. In recent years the all-Ceylon average yield per net acre harvested varied from 25.95 bushels in Maha 1952-53 to 32.93 bushels in Yala 1955. The yield per acre is liable to considerable fluctuation.

These uncertainties of yield are not peculiar to paddy. The whole range of chena products are liable to be affected by weather conditions. They are often at the mercy of wild animals. Chena, being a system of shifting cultivation, it is not profitable to fence a chena elaborately. Protection against wild animals is done by erecting scarecrows or ringing of bells to scare away animals, and the farmer usually sleeps in a watch-hut armed with a gun. Despite these precautions wild animals trample and destroy chenas. Other crops too carry the usual risks associated with agricultural production in a tropical climate. Pests and diseases too are common; the blisterblight in tea, oedium in rubber, the beetle in coconut, the paddy bug in paddy, to mention a few of the pests attacking the different crops. Indeed the entire coffee industry of Ceylon was ruined by the coffee-leaf disease of the seventies of the last century.

It is possible, but unnecessary, to multiply the evidence on the uncertainty of yields arising out of natural causes. The uncertainties reduce the farmer's control over his production. Further, any improvement in technique like the application of artificial manure or the selection of better seeds may not yield an adequately high return in any given season owing to these natural factors beyond the control of the farmer. He really may not reap what he sows. Scientific research tends to reduce some of these uncertainties, but in the present state of the application of science to agriculture in Ceylon considerable uncertainties of yield still exist, more so in the case of paddy and other peasant crops than in the case of tea and rubber. Uncertainty of yields is a matter which the lender can do little about. It is a risk which has to be taken for granted. In certain countries, notably in the U.S.A. a system of crop insurance has been adopted to cushion the farmer against such risks. From a credit point of view crop insurance will remove the uncertainty of yields; crop insurance is itself a larger subject which cannot be discussed here. Purely from a credit angle a system of crop insurance in Ceylon is a desirable thing.

If uncertainty of yields results in risks of production, so do uncertainties of price. In this respect the small farmer in Ceylon is better off because the Government administers a Guaranteed Price Scheme (GPS), covering a wide range of rural agricultural products. The GPS applies to paddy, maize, kurakkan, sorghum, mustard, gingelly, chillies, green gram, tamarind, black pepper, coffee seed, turmeric, cowpea, groundnut and oorid. The guaranteed price is a floor price. The producer is free to obtain a higher price in the open market. The price is free to fluctuate above the minimum fixed by Government. In fact, until recently open market prices of some of the commodities like paddy were higher than the guaranteed price. Very little information is available about the actual prices at which the farmer sells his produce. The prices in the table below serve to illustrate the extent of fluctuations in prices between one year and another. These are not prices actually received by the producer. They are wholesale prices in Colombo. The prices received by the producer would be less but would fluctuate with some relation to these prices. It is evident that there are considerable price fluctuations between one year and another.

TABLE II

Wholesale prices—Colombo Town

Commodity	*Unit*	1948(*a*)	1952	1953	1954	1955
			In Rupees			
Local rice—raw ..	80 measures	—	63.50	82.35	63.15	55.40
„ „ parboiled	80 measures	—	67.00	82.65	63.25	55.75
Green gram ..	200 lbs.	65.70	65.20	74.30	58.05	44.90
Chillies dried ..	Cwt.	115.75	121.95	128.35	151.80	105.15
Onions red (*b*) ..	Cwt.	18.00	65.35	37.75	47.10	26.25

(*a*) average prices for the months of November and December.
(*b*) up to September 1949 prices were controlled.

Source:—Statistical Abstracts of Ceylon.

The instability of prices of local produce may be due to a number of reasons. First, a large proportion of the national income is earned by producing for export markets in which prices tend to be unstable.[4] Instability of export prices affects the prices of rural produce directly in so far as export products are grown in the rural sector. Indirectly, the prices will be affected via the incomes of the export producers, both employers and employees, and the consequent income elasticities of demand for rural produce. Secondly, there would be price fluctuations in the rural produce markets due to conditions in those markets themselves. As stated earlier, the farmer is uncertain about his yields. He cannot regulate the supply to suit the demand for his produce. A bumper crop may well leave him worse off because of a glut in the market. The effects of over supply would be mitigated by the operation of the GPS. However, the success of the scheme depends on the efficiency of the purchasing organisation at village level. Complaints are often heard that the middleman is still able to cut in and buy at lower prices from producers and to sell to Government at guaranteed prices. It is not possible to state the extent to which such malpractices obtain in the rural areas. The guaranteed price, if the producer can sell at the price, offers a safeguard against a fall in price resulting from a temporary glut in the market. Thirdly, the world market prices of the rural products themselves have their effect on local prices.

4. *Report of the Taxation Commission*, p. 102. S.P. XVII of 1955.

Import duties and guaranteed prices can correct any temporary divergence between local and world market prices but it would be difficult to correct a fundamental divergence by these means. Where there is some prospect of the local supply meeting the local demand, as happened in the case of onions, Government would be justified in protecting the local farmer. In other cases unless the Government is prepared to subsidise the farmers, as in England and the U.S.A., the local prices would vary with world market prices. In fact the world market prices of rice has fallen since 1953 and the local price moved in sympathy until it reached the guaranteed price level. It does not fall below that because the Government is now subsidising the paddy farmer. At prices higher than guaranteed prices world market prices would have an effect on local prices.

There are also more long-run uncertainties arising from the length of the production period. This is relevant only to those crops which have a long gestation period between planting and yielding. Crops like tea, rubber, coconut and cocoa take from five to eight years after planting to yield any crop at all; optimum yields are obtained only after fifteen or twenty years. Their yields, even after such a long period of waiting, depend to a large extent on natural conditions. Their prices are determined in the world markets in which Ceylon, being a small exporter, has little or no control. Under the circumstances the farmer has to take a very long view in planting such crops anew or in replanting. Long-term expectations in Ceylon's export markets are very variable, as stated earlier. Further, the post-war period has on the average been one of buoyant prices for Ceylon's exports; this has led to rather optimistic expectations. Lending to farmers for the development of these crops can be very risky under the circumstances.

To sum up, there are considerable uncertainties of both yield and price, in the short-run as well as in the long-run, in the case of crops cultivated by the small farmers in Ceylon. Uncertainty about yield can be remedied to some extent by crop insurance. In the absence of crop insurance in Ceylon the lender has to cover himself by charging a higher rate of interest, a part of which may be considered as an insurance premium to cover the high lending risks. Uncertainties of price are reduced by the operation of the GPS. In the case of those crops to which the scheme applies, the risks of lending are minimised to the extent that prices do not fall below a certain minimum level. In the case of other crops price uncertainties are a potent factor in increasing the risks of lending especially so in the case of export crops. The perennial crops take a long time after planting before they yield; and their life-period is also long. Consequently, capital tends to get tied up over a long period during which prices can fluctuate adversely. Long-term lending for the purposes connected with such crops would be very risky. All these factors contribute to the high risks of lending in the rural sector. Rates of interest are high partly because the lender has to cover himself against these risks by charging a high rate.

Lack of suitable security

The lack of suitable security is one of the chief factors preventing an easier flow of credit to the rural sector. In a poor country the assets available for pledging as security are few. Where there has been little capital formation there is little to offer as security. This is especially true of the rural small farmer sector as shown in Table III.

TABLE III

Rural Ceylon, Average value of property per family 1950-51

Description	*Value (Rs.)*
Land	1331
Livestock	90
Goods	478
Buildings	866
Total ..	2765

Source:—Final report of the economic survey of rural Ceylon, 1950-51.

The average family owned under Rs. 3000 worth of property of which land constituted the major proportion. Even if all the assets were acceptable as security and a lender were willing to lend 75 per cent of the value of assets, the total loan which the average family could obtain would be about Rs. 2000. This would have to suffice for all needs. Further, not all the property belonged to the family either; the average debt, as stated earlier, was 9.5 per cent of the value of property. Thus the net worth of the average family was only about Rs. 2500. From the point of view of a lender the credit worthiness of a borrower whose total assets amounted to only Rs. 2500, most of it not liquid, must seem very poor. So much for amount of the security. Its suitability is another matter.

A peculiar feature of agriculture in Ceylon is that there is little livestock farming as such. The average family owns only a few animals as the table below shows. The average family owned about three animals valued at Rs. 90. Even they are known to be

TABLE IV

Average number of livestock per family, rural Ceylon 1950-51

Description	*No. of animals*
Bulls	0.31
Cows	0·65
Buffaloes	0.30
Goats	0.29
Pigs	0.05
Poultry	1.14
Others	0.09
Total	2.83

Source:—Same as Table III.

not quite healthy. Livestock is usually regarded as unsatisfactory security for loans because it is liable to be destroyed by epidemics and unless there is a proper system of branding, animals are difficult to identify. Unhealthy livestock, not properly branded, as is the case in Ceylon, can hardly be considered as suitable security.

In the category of goods, stocks of grain and other crops, household effects, jewellery and consumer durables would be included. The total value of such goods per family was Rs. 478. They are all movables. Of them, taking the conditions of rural life into cosideration, only jewellery and stocks of grain and other crops would be suitable as security. The rest would be articles of everyday use which would have little commercial value. All movables suffer from certain inherent defects as a form of security. Their mortgage is governed by the existing law of mortgage as applied to movables. They can be mortgaged either by delivering them to the custody of the creditor or by registering a document of mortgage.[5] Where the movables are delivered to the creditor, he must come into

5. The law in Ceylon is governed by the *Mortgage Act No. 6 of* 1949 and its subsequent amendments.

possession by storing them in a place which belongs to him. In the case of valuables which are small in relation to value, the problem of storage will not be one of space but one of adequate protection against theft, loss by fire or other damage. In the case of goods which are very bulky in relation to value, like crops, the creditor will require a spacious storehouse to accommodate his pledges. A further difficulty is that crops are liable to perish if stored for too long a period. They would also be subject to fluctuations in value. Durable consumer goods also depreciate in value even if they are not in use. All these factors tend to make movables quite cumbersome as a form of security even when they are pledged. The risk of depreciation in value is also high.

Where the goods are not pledged but a mortgage is created by the registration of a document, the borrower remains in possession of the goods. There is no problem of storage but the arrangement gives little security to the lender. Since the movables as the name connotes can be moved from place to place, it will be difficult to identify the mortgaged goods. The goods can be given or sold to a third party who would normally be unaware of the existence of a mortgage on the goods. The law recognises the title of such a third party; where the mortgagor of movables is left in possession of the goods, a mortgagee cannot follow the movables into the hands of an innocent purchaser or donee. Further, when the goods are allowed to continue in daily use the depreciation would also be high. Thus while a pledge of movables gives a mortgagee at least some security, the mere registration of a document is of little avail against a borrower who wants to defraud wilfully.

The mortgage law of Ceylon makes a distinction between an "approved credit agency" and an ordinary lender. An approved credit agency has the legal right to sell the mortgaged goods without a court decree after giving due notice to the mortgagor. An ordinary lender has to seek the aid of a court to get a Receiver appointed and thereafter proceed to sell the goods and recover his money through the courts. Licensed pawn brokers can sell the pledges by public auction. Other ordinary lenders have to undergo a cumbersome court procedure before recovery can be effected. The distinction between ordinary lenders and approved credit agencies confers an advantage on the approved credit agencies. The ordinary lender has to undertake a bigger risk and has, therefore, to cover himself by charging a higher rate of interest not only to meet the higher risk but also to meet higher costs in case he is forced to take legal action.

It is seen that lending on the security of movables results in high risks to the lender, especially to those who do not fall within the favoured class of approved credit agencies. The mortgage of movables is not popular in Ceylon. According to the *Administration reports of the Registrar General*, out of 436351 mortgages registered between 1950 and 1955 only 6288, or less than 1.5 per cent were mortgages of movables. In the data on rural indebtedness no distinction was made between mortgages of movables and immovables but it was seen that debts secured by pawns accounted for less than 6 per cent of total debts; all mortgages of movables would have accounted for a somewhat higher percentage.

While on the question of movables there is another problem which may appropriately be discussed here, namely, the hypothecation of crops. The assets available to the small farmer for pledging as security are few and mainly unsuitable. His standing crop, on the other hand, is, in some cases, the only kind of security he can offer. The Banking Commission recommended "the provision of special legal facilities for the 'registration of hypothecation' of crops in favour of banks, with power to seize and sell the crops on the same lines as those laid down in the 'English Agricultural Act' of 1928.[6]" A draft Bill was prepared but was never enacted. The Mortgage Commission too went into the problem and recommended the adoption of a draft ordinance for the purpose.[7] The draft ordinance granted facilities for the hypothecation of crops to approved credit agencies but withheld from them the right to seize and sell the crop in case of default. Instead, provision was made for the appointment of a Receiver immediately upon the filing of a plaint. This legislation too has not yet been enacted and consequently there is no special law in Ceylon which regulates this important aspect of agricultural credit. In practice, however, the unsecured debts of rural farmers are incurred on the implied security of his crops. The boutique keeper sells his goods against the security of the crops of the farmer. It is

6. *Report of the Ceylon Banking Commission*, p. 132. S.P. XXII of 1934.

7. *Second interim report of the Commission to inquire into the law relating to mortgage, credit facilities and the protection of lands of agriculturists*, S.P. V of 1945, p. 16. This Commission will be referred to as the Mortgage Commission.

an implied contract, unwritten but normally adhered ~~to~~ by custom rather than law. In the past this system has worked against the best interests of the farmer, as will be shown in a subsequent chapter. Legal recognition of the hypothecation of crops will confer a distinct advantage by removing some of the malpractices to which the farmer may now be subjected by the private produce dealers.

The immovable property which the rural farmer can offer as security consists of land and buildings whose total value was Rs. 2197 per family. There are certain inherent defects of land as a form of security, namely that land is subject to fluctuations in value, that realisation in case of default involves cumbersome procedure and that there are complications of title to land.

Agricultural land values in Ceylon tend to fluctuate in sympathy with the prices of agricultural products. When the price of a crop grown on a particular land is high its value naturally increases and, vice versa. Further when crop prices are high and there is general prosperity in the economy the value of land too increases. The following table shows some hypothetical land values worked out on the basis of their respective crop prices. Actual transaction would

TABLE V

Trend of agricultural land values

Year	*Coconut*	*Tea*	*Rubber* (*in rupees per acre*)
1941	300	650–700	400–500
1942	500	750	400–500
1943	500	700	400–600
1944	750	700–800	700
1945	800	1,000	700
1946	800	1,000–1,250	600–700
1947	800–1,000	1,000–1,400	400–450
1948	1,000–1,200	1,000–1,200	350–400
1949	1,000–1,200	1,000–1,400	300

Source:—N.U. Jayawardene, *Report on the State Mortgage Bank*, S.P. VII of 1951.

have taken place at different prices but the general trend would have been similar since prosperity and depression in Ceylon depend to a large extent on the prices of these three commodities. During the period the prices of coconut and tea properties have increased steadily but that of rubber has been more erratic. The prices of the commodities have been generally buoyant during the period in contrast to the 'thirties. Creditors would have found that the value of their securities were appreciating, but the opposite tendency too takes place, as it happened between the 'twenties and the 'thirties. What is really distressing about a fall in land values is that it generally coincides with a period of depressed prices, the very period during which debtors are liable to default in repayment. The risks of loss in realisation under those circumstances would be high, as in 1932, when creditors were forced to acquire mortgaged lands in preference to realisation by sale, due to the depressed state of the market.[8] The experience of 1932 would have tended to magnify the risks of accepting land as security in the minds of creditors who would want to insure themselves against the risk of recurrence of such a situation by charging high rates of interest.

The procedure involved in realisation is governed by the law of mortgage. The defects of the law have been examined by a number of Commissions since 1934. It is not proposed to repeat in detail the various matters discussed by them and their recommendations. Their combined efforts led to the enactment of the new Mortgage Act No. 6 of 1949. It is proposed to examine, in brief, the chief defects which existed in the earlier law and how far the new Act helps to remedy them. The first ground of complaint was the delay and expense in realisation of mortgages. Realisation requires a court decree. The debtor is in a position to adopt dilatory tactics by bringing up technical objections against the grant of the decree. He may deny liability in which case the fact of liability has to be established before decree can be entered. All this leads to considerable delay. It also leads to additional expenditure which must go to swell the cost of credit. From the point of view of facilitating the flow of credit it would be preferable to permit the creditor to realise the value of the security without a court decree. In fact, the Banking Commission suggested that the Indian law, whereby the creditor can realise his security by sale or enter into possession or appoint a Receiver without recourse to a court, should be adopted in Ceylon.[9]

8. *Report of the Ceylon Banking Commission*, 1934, p. 169.
9. op. cit. pp. 105 and 106.

The Mortgage Commission, however, thought that the mortgagee in Ceylon should not be granted such powers.[10] There are two opposing considerations in this question. On the one hand, easier realisation would reduce both the risks and costs of lending. On the other, such a step would give inadequate protection to the borrower against arbitrary action by the lender. This second consideration is important especially because the money lender in Ceylon, as elsewhere, has had a dubious record. The new Act, therefore, embodied the recommendation of the Mortgage Commission. In the case of immovables no distinction has been made between ordinary and approved credit agencies, unlike in the case of movables. The Ceylon State Mortgage Bank and the Agricultural and Industrial Credit Corporation have special powers of foreclosure written into their constitutions. If the privilege had been extended to all approved credit agencies there might have been a greater flow of mortgage credit, but it is unlikely to have led to a greater flow of credit to the rural sector because there are many more obstacles inhibiting the flow of mortgage credit to the rural sector. Further, the other institutional credit agencies do not lend to small farmers not only because recovery is cumbersome but also because there are other risks and high costs. Nevertheless, if the privilege is extended to other approved credit agencies as well it may facilitate mortgage lending in the rest of the economy.

A second defect arising from the delay in realisation is that the borrower who remains in possession of the land tries to extract the best out of the land and leave the lender a worthless asset. At times the borrower is known to adopt dilatory tactics deliberately in order to get some time in which to extract all he can from the land. This defect has been remedied in the new Act and by the Mortgage Amendment Act No. 53 of 1949. The Act itself provides for the appointment of a Receiver on an application to the court, the appointment being left to the discretion of the court. The amendment seeks to make the appointment obligatory in a case where the court is satisfied that the mortgagor or other person in possession of the land has committed an act of waste in respect of the land. The law in its present form provides adequate protection to the mortgagee against wilful waste by the mortgagor after the former has taken some form of legal action. Where the borrower

10. Second interim Report, pp. 30 and 31.

practices any wilful waste over a long period before the lender gets to know it, no law can provide adequate protection. It is the responsibility of the lender to select such borrowers as would not resort to those practices wilfully.

A third deficiency in the law which was referred to both by the Banking Commission[11] and the Judicial Commission[12] was the lack of provision for mortgage by the deposit of title deeds, or "equitable mortgage" as it is known in England. This type of mortgage is advantageous in that it reduces the stamp duty payable and does away with the need for a notarial deed of mortgage of the land. It actually helps to reduce the costs of a loan and should really be dealt with in the section on high costs of lending. It is considered here because it is convenient to discuss the defects of the law in one place. The Mortgage Commission recommended that the facility should be restricted to approved credit agencies.[13] The new Act has embodied their recommendation.

The mortgage law of Ceylon has attempted, by its latest revision, to remove the disabilities affecting both movables and immovables. In doing so, it has conceded an important principle, namely, discrimination in favour of approved credit agencies. A further instance in which such discrimination might profitably have been extended is to have enabled such credit agencies to sell or enter into occupation or appoint a Receiver without recourse to a court where there has been default in a mortgage of immovables. However, the distinction between ordinary and approved credit agencies which has been made is important for the future development of agricultural credit in Ceylon. The new Act defines an approved credit agency in the following terms:—

"In this Act 'approved credit agency' means—

"(*a*) any banking company as defined in Section 330 of the Companies Ordinance, No. 51 of 1938, which is declared by the Director of Commerce, by notification published in the *Gazette*, to be an approved credit agency for the purposes of this Act.

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11. op. cit. p. 105.
12. *Report of the Judicial Commission*, S.P. VI of 1936.
13. 2nd Interim Report, p. 15.

"(*b*) the Ceylon State Mortgage Bank, the Agricultural and Industrial Credit Corporation, the Loan Board, the Ceylon Savings Bank, and the Local Loans and Development Commissioners.

"(*c*) any other company, firm, institution, or individual for the time being declared by the Director of Commerce, by notification published in the *Gazette* to be an approved credit agency for the purposes of this Act."[14]

Applications for approval are considered by a Board consisting of three members appointed by the Governor General. The Board's decisions are final and it has the right to revoke the approval of any agency.

Complications of title to land are a serious handicap to the suitability of land as security. The Commissions referred to earlier, have all drawn attention to the urgent need for a system of registration of title to land, but, as yet, there is no proper system of registration in Ceylon. As early as 1863, about the time the Torrens system was adopted in Australia, an Ordinance for the registration of land was enacted in Ceylon.[15] It provided for the registration of title to land as well as for the registration of deeds. The latter was meant only as a temporary expedient until proper surveys and the necessary investigations of title could be completed. However, the law relating to registration of title never came into force while only the registration of deeds took place. Another Ordinance was enacted in 1877.[16] By a proclamation dated November 11th 1887, five divisions in the Western Province, in which a cadastral survey had already been completed, were declared to have fallen within the provisions of the Ordinance.[17] The procedure was found to be too complicated and expensive and the scheme after trial in a small area was abandoned. Yet another Ordinance was passed in 1907 but was never proclaimed. Since then a number of Commissions and officials and others have expressed the desirability of having a proper system of registration of title. A special Committee was appointed in 1934 "to inquire and report on the question of registration of title to

14. Mortgage Act No. 6 of 1949, Clause 3.
15. Ordinance No. 8 of 1863.
16. *Land Registration Ordinance*, 1877.
17. *Report of the Special Commissioner for the registration of title to land*, S.P. XXIII of 1890.

land in Ceylon." They concluded that past failure had been due to the high costs involved and the attempt to achieve an ideal system. They recommended an 'expeditious and cheap' system based on the principle that "a register of indefeasible title upon which absolute reliance can be placed and upon the strength of which any person desiring to acquire title can invest his money with safety is the cornerstone of the whole system".[18] Their scheme consisted of provisional registration followed up by confirmation of indefeasible title if no objection was raised within a given period. An insurance fund was to be created to compensate any person, who through no fault of his, was deprived of any of his rights by the application of the system. They provided for both compulsory and voluntary registration, the choice being left to the Government. The physical basis of their system was a survey. Their recommendations were embodied in a draft Ordinance which was not passed. The problem was then referred to the Mortgage Commission. They agreed with the principal recommendations of the 1934 Committee but opposed compulsory registration. They also thought that the expensive procedure of cadastral surveys was unnecessary and that the identity of isolated blocks of land could be fixed with certainty by sporadic surveys. They recommended the adoption of a comprehensive draft Ordinance for the purpose and the establishment of a Department of the Registrar of Title.[19] These have not been implemented. The result of almost a century of indecision is that Ceylon has had a system of registration of deeds and not of title.

The difference between registration of deeds and registration of title has been stated as follows:— "Registration of Deeds is essentially an unsatisfactory and imperfect procedure which may be made to function efficiently in spite of its weakness, but not on account of its intrinsic merits. In Registration of Title the machinery of record transfers primary attention from movable, evanescent, mistakable units—documents and human beings—to immovable, indestructible and precisely defined units—the parcels of land affected, so that the current situation is always obtained at a glance. The record can thus be initially constructed and indefinitely maintained with reference to the existing parcellation of land at any and every moment".[20]

18. S.P. V of 1935.
19. 4th interim report, S.P. III of 1946.
20. See Ernest Dowson and V.L.O. Sheppard, *Land Registration*, p. 71.

The lack of a proper system of registration of title to land affects the suitability of land as security in two ways. First, the establishment of title becomes a long drawn out process involving the examination of a bundle of deeds each time a particular parcel of land is offered as security. It results in repeated, imperfect and costly examination of title and even so does not yield a perfect title. This leads to considerable delay. Secondly, it also leads to additional expenditure for the payment of notaries' and search fees. Both delay and costs are a hindrance to the flow of credit and reduce the suitability of land as a form of security for loans.

There is also a further factor which makes some lands unsuitable, namely the prevalence of tenures other than freehold or leasehold. This disability is not general and applies only to particular lands. Vestiges of the ancient system of Service Tenure, known as *Rajakariya*, are still present in some lands.[21] The extent of land affected by service tenures is supposed to be small[22]. In the case of paddy lands, Table II of Chapter IV showed that less than three per cent of all holdings amounting to less than 6 per cent of the area fell in the "others" category, only a part of that was subject to service tenure. A commission inquired into the problem in 1955 and recommended the abolition of *Nindagam* (privately owned service tenure lands) but advocated the retention of *Dewalegam* and *Viharagam* (lands belonging to temples, where the cultivators are obliged to render certain services like the beating of tom-toms or the maintenance and administration of temples). They also concluded that the services have almost completely fallen into desuetude in the case of *Nindagam*. Service tenures are not widely prevalent but, those lands to which they apply would be unsuitable as security for loans because their occupation involves the rendering of certain services.

There are other lands on which the tenancy makes them unsuitable as security. In the case of paddy lands, only 55 per cent of the acreage was owner-cultivated, as seen in Chapter IV. The rest was cultivated under various forms of tenancy, the most important of which were the *ande* system, *tattumaru* ownership and lease.

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21. For a full discussion of ancient systems of tenure in Ceylon see Colvin R. de Silva, *History of Ceylon* and H.W. Codrington, *Ancient Land Tenure.*

22. *Report of the Commission on tenure of lands of Viharagam, Nindagam and Devalegam*, S.P. I of 1956, p. 28.

Provided the lease is for a long period, the lessee has reasonable security but the land itself would not be acceptable as security. The *tattumaru* system is worked on jointly owned fields where sub-division into separate holdings would not be practicable. The share of each owner is not demarcated and such a property too would be unacceptable as security unless all the co-owners take the loan jointly and are responsible for its repayment. Under the *ande* system the tenant is a share cropper. From the point of view of a lender the tenant has no more status than a landless labourer. He does not own the land and cannot therefore pledge the land as security. A new kind of tenancy has been created by the Land Development Ordinance of 1935. It regulates the rights of a tenant on land alienated by Government mainly in the colonisation schemes. The tenant is forbidden to lease or mortgage the land to anyone other than the Government. This means that for credit purposes the peasant in the colonisation schemes is no better than a landless labourer. These restrictions on tenancy whether they take a traditional form or otherwise result in making such lands unsuitable as security for loans.

Land in Ceylon is, therefore, not a very satisfactory form of security due to the fluctuations in value, difficulties of realisation, lack of registration of title and the peculiarities of tenure on some lands. Under the circumstances if credit is to flow freely into the rural sector, the disabilities of land must be removed as far as possible and the lending institutions must be adapted to suit the peculiar circumstances.

The low incomes of small farmers

It is risky to lend money to a man of small means, especially if his income is subject to uncertainties both of yield and of price. If his crop fails he would be unable to repay his loan and since the security is also not too sound the risk is even greater. The average income of the small farmer in Ceylon is small; for a family of 4 to 5 persons, even in the boom year of 1950-51, it was only Rs. 96.80 per month, the median income was only Rs. 77.52. Not only is the income small but it is unstable as well. Nor does the small farmer have adequate and suitable security to offer for loans. Under those circumstances lending is bound to be a very risky operation.

The incomes of small farmers in Ceylon are low because, on the one hand, the size of their holdings is low and, on the other, there are few opportunities for employment outside their small holdings. The farmer owns only a small holding because of historical reasons. First, the expansion of the area under cultivation has not kept pace with the growth of population as the table below shows. The pressure of population on the land has tended to reduce the extent of cultivated land per head of rural population. It is significant

TABLE VI

Ratio of cultivated land to rural population

Year	*Cultivated area per head of rural population (acres)*
1891	0.75
1901	0.71
1911	0.75
1921	0.72
1931	0.72
1946	0.57
1950(*a*)	0.54

(*a*) Estimate

Source:—Planning Secretariat, *Six-Year Programme of Investment* 1954-55 to 1959-60.

that the rapid fall in the area of land per head of population took place after 1931 despite the efforts after that date to colonise the Dry Zone. It was also stated earlier that the median size of holding in the rural sector was only 0.82 of an acre. The extent of fragmentation in the Wet Zone is greater than in the Dry Zone, where there is as yet room for expansion. A second historical reason why the size of holding is small in the Wet Zone is that the growth of plantations resulted in reducing the area available for expansion. With the better demarcation of Crown land under the Crown Lands Ordinance of 1840 and the Waste Lands Ordinance of 1898, and their subsequent sale to planters for the planting of tea and rubber and other commercial crops, the villages in the Wet Zone lost the land available for expansion. The Crown lands were, no doubt, sold by auction but the small farmers could not bid on equal terms especially with large foreign capitalists. Consequently they could not buy more land for no other reason than their own poverty.

A second reason why the farmers' incomes are low is because there are few opportunities for employment outside their family holding. It has already been stated that there has been very little shift of population to the urban areas. This is because there has been no industrial development. The only forms of employment which draw people to urban areas are Government service and the few opportunities available in commercial enterprise. In this respect, the growth of plantations could have been a boon to the villagers but for the fact that a substantial part of the labour force on tea and rubber estates is of Indian origin, as shown in Chapter II. The coconut industry which has the largest area of contact with the rural sector is, unfortunately, not a labour intensive crop. In recent years employment opportunities have been provided by the Government in colonisation schemes and other development schemes. However, their rate of expansion has not yet been adequate to cope with the increase of population. The problem is likely to get even worse in the future. The economy is at the moment providing employment to those born prior to 1946, after which the rapid increase in population took place due to a fall in the death rate, including the infantile mortality rate. Those babies who survived due to the fall in the infantile mortality rate after 1946 would reach employable age by 1960 and, then, there would be a marked increase in unemployment which, in the absence of sufficient opportunities outside, will seek absorption into the rural sector. The problems of rural poverty and population pressure on land are likely, therefore, to get worse in the near future unless alternative employment opportunities become rapidly available outside the present rural sector. Other things remaining the same, average rural incomes are likely to fall even further. Despite the size of rural holdings incomes can be larger but for the fact that the techniques of production employed by the farmers are primitive. More intensive cultivation can lead to higher incomes from the same holdings. Perhaps, as farms get smaller the farmer would have additional incentive to adopt more intensive methods of cultivation in order to be able to keep his family even at the present low standard of living. On the other hand, a small holding may have an inhibiting effect because a farmer who has a very small holding is likely to be reluctant to try experiments which to his mind can lead to failure. The point is that the prospects are that average incomes in the rural sector may fall unless more intensive cultivation is done or more opportunities are available for employment outside agriculture.

From the point of view of credit a small income reduces the credit-worthiness of the borrower; it, therefore, increases the risks of the lender. It is also often supposed that the small farmer is not credit-worthy because he is dishonest. It is not possible to say anything about the personal integrity of small farmers as a class. There must be dishonest farmers even as there are dishonest persons in other walks of life. There are no grounds for arguing that there is greater dishonesty among farmers than elsewhere; perhaps, the idea arises because the farmer with his low and unstable income tends to default more frequently. If he does it is not because he is dishonest, but because the very nature of his income leaves him little choice.

The insecurity of tenure

Tenurial relationships in so far as they affect the suitability of land as security were already discussed in an earlier section. Their effect on incentive to development were discussed in Chapter IV. Here the point of relevance is the low credit-worthiness of a tenant whose tenure is uncertain. Under the *ande* system the tenant is a share cropper at will. He has no security of tenure because the landlord is free to change his tenant every season; in practice he does not do so. The crucial point, however, is that the landlord is under no legal obligation to retain his tenant for any length of time. What is relevant for a commercial transaction is the legal right of the tenant and not the social obligation of the landlord. Legally the tenant has no right of secure tenancy; even the share of his crop is regulated by custom and not law. The new Paddy Lands Bill will give him a legal right to secure tenancy. Until then the lack of security of tenancy adds to the instability of the farmer's income, and, thereby, increases the risks of lending to him.

To sum-up, the risks of agricultural production, the lack of suitable security, the low incomes of small farmers and the insecurity of tenure result in increasing the risks of lending to small farmers. The lender has, therefore, to charge a rate of interest that would not only cover his costs and give him a reasonable margin of profit but also provide him a cover against loss of capital. Part of the rate of interest charged is an insurance premium for the high risks which the lender assumes. The point is that there is economic justification for charging a higher rate than on commercial transactions.

The interest rates may also be high because the cost of lending is high. This may be due to higher costs involved in lending to a large number of small farmers and because the lenders themselves borrow at high rates or because the opportunity cost of lending to small farmers is high.

The small farmers are spread throughout Ceylon. They are rather densely concentrated in the Wet Zone but less densely concentrated in the Dry Zone. Ceylon itself is, however, a compact island, with a comparatively good system of communications. Further, although the small farmers are spread throughout Ceylon, the villages themselves are compact units both in the Wet Zone and in the Dry Zone. The costs of supervision and administration of a central credit organisation may be high but small operators concentrating in compact areas are likely to find that their costs are not much higher than elsewhere, at least, not on the grounds that they have to deal with a large number of widely spread small farmers. Apart from this the costs of realisation, as shown in an earlier section, are high, due to complications of title and the delay involved in court procedure.

There is very little information available about the rates at which moneylenders borrow their capital. In dealing with the activities of moneylenders in Chapter VIII some remarks will be made about the costs of moneylenders.

In this chapter, it has been established that the risks of lending to small farmers are very high. It may also be that the costs of lending are high. Whether that is so will be examined in later chapters; likewise, the question whether any lenders in the rural sector possess any monopolistic advantages whereby they are able to charge high rates of interest for their loans cannot be answered until the nature and working of the different credit agencies in the rural sector have been examined. The basic problem which has to be explained is the prevalence of high rates of interest in the rural sector. There is no doubt that high risks lead to high rates of interest. At the same time Co-operative Societies have been lending under similar conditions for almost half a century at much lower rates of interest. The questions to which, therefore, the next three chapters must supply answers are:—

(*i*) Why have the high cost credit agencies been able to survive despite the competition of Co-operatives and other Government sponsored credit institutions?

(*ii*) Under what conditions of cost and risk do each of the rural credit agencies operate?

(*iii*) Do high risks and costs offer an adequate explanation of the rates of interest charged by each agency?

(*iv*) If not, do any of the agencies possess special advantages which they can exploit to obtain high rates of interest? And if so, what prevents others entering the field to compete with them?

It is only in answering these questions that a complete explanation of the rural credit market can be found.

CHAPTER VI

Sources of Credit—I

Origins of agricultural credit

In the ancient agricultural system of Ceylon an elaborate credit system was unnecessary. The King, who was owner of all the land had it cultivated by his people under a complex system of service tenure or *Rajakariya* as it was called. The King was a benevolent despot and looked after the economic needs of his people.

The ancient system broke down under the influence of foreign invasions and foreign commerce. The Portuguese, the Dutch and the British in turn ruled the maritime provinces from 1505 to 1815, at which latter date, after centuries of divided rule, Ceylon was unified under British rule. The Portuguese and the Dutch were preoccupied with strategic issues and the cinnamon trade; they devoted little or no attention to the needs of the indigenous small farmer. Under British rule, the need for capital to develop agriculture was realised as early as in 1817 by at least one civil servant, as the following extract shows:— "It is not land that is wanted to the population of the country, there is a sufficiency of it to maintain four times the number of its present inhabitants, if there were capital to put into cultivation all the land that is capable of being applied to the support of man. The population wants capital to give employment to labourers, either in agriculture or in manufacture"[1]. By 1830 the flow of capital into agriculture had begun. It flowed into the large scale plantation of coffee, at first, and tea and rubber subsequently. It did not flow into the indigenous sector for good reasons. The capital which was invested in plantation agriculture was risk capital coming from the European financial centres, especially London. It was seeking opportunities for investment in the undeveloped colonial territories where virgin land, with promise of high returns, was available. The land laws, like the Crown Lands

1. Anthony Bertolacci. *A view of the agricultural, commercial and financial interests of Ceylon*, p. 72.

Ordinance of 1844, facilitated the process in so far as they helped to demarcate crown lands, which were subsequently sold or leased out to foreign investors. Further, with the rapid industrialisation of the West, an ever-widening market for primary products was opening up. Consequently, foreign risk capital went into plantation agriculture in the expectation of high profits arising both from high returns on virgin land and high prices in an expanding market. The history of the plantations in Ceylon shows that these expectations were substantially fulfilled. The indigenous sector offered no such scope for high profits. It was still rooted in the ancient system of agriculture and was producing largely for subsistence. The market for its crops was small.

Meanwhile, the impact of Western culture and imports tended to expand the consumption pattern of the indigenous farmer. While his production was still rooted in subsistence farming his needs were expanding and driving him to the market place. The growth of the plantations and the expansion of population were constantly reducing the area of land available for expansion in and around the villages, especially of the Wet Zone. Migration into the Dry Zone was not possible due to the lack of irrigation facilities and the high incidence of disease in that zone. Some minor attempts at ameliorating the conditions of the small farmer, like the restoration of some village tanks, were made by Government but there was no concerted attempt to solve the overall problems of the small farmer.

These conditions, naturally, appear to have driven the farmer to the private moneylender. No precise data on the extent of indebtedness in those early years of British rule are available, but, there is evidence to show that the indigenous farmer was substantially in debt to the private moneylenders by the end of the nineteenth century. For instance, there is the following observation made anonymously in 1884:— "Capital is wanted to push paddy cultivation on in the North and East.—In Batticaloa the petty farmers or cultivators are yearly swamped by the big *podis* or rich landowners. They are swallowed up in scores as minnows are by the whale. They cannot carry on cultivation in their small fields without some sort of capital. The *podi* lends this capital often in the shape of paddy for what is known as paddy-interest, which is even more exorbitant than usury. Year by year the poor cultivator gets more and more into the *podis'* debt and finally his land is absorbed in the big *podies'* broad acres"[2]. These conditions were apparently not peculiar to Batticaloa for an article[3] written in 1893, describes the evils of the generally prevalent system of lending seed paddy and goes on to recommend a Government loan system at 3 or 4 per cent interest. Another article by the same author,[4] written in 1901, discusses the causes of the paddy cultivator's reduced prosperity, namely, the small size of the individual holding, exhaustion of the soil by continuous cultivation without fertilizers, the increase in expenses due to the expansion of the cultivator's household budget and the higher prices of articles of daily use. The reduced prosperity of the paddy cultivator drove him to the moneylenders who charged high rates of interest—20 to 30 per cent per annum for a mortgage loan; 50 to 100 per cent for four months on advances against crops, working out to 150 to 300 per cent per annum. He thought that the interest rates were high due to the lack of alternative credit facilities and suggested the establishment of agricultural banks like those in the Deccan, India, and in New Zealand and Australia. A very rough estimate made in 1906 puts the total of indebtedness of "people who own movable or immovable property in Ceylon" at a minimum of Rs. 80 million at rates of interest ranging between 18 and 60 per cent[5]. Such evidence as is available suggests that by the beginning of this century the small farmers were impoverished and substantially in debt to private moneylenders. The farmers were themselves probably unaware that interest rates could be lowered if suitable credit facilities were provided. A few people appear to have realised the potentialities of a suitable agricultural credit system but a concerted demand for such facilities cannot be said to have started until 1904.

In 1904, the Ceylon Agricultural Society[6] was formed at the instigation of the Governor, Sir Henry Blake. Its object was the

2. Extract from a letter signed NEM. CON. to the Editor of the Ceylon Observer of 15th April, 1884.
3. W.A.D.S. "Paddy Cultivation", *Magazine of the School of Agriculture*, Colombo, June, 1893.
4. *Tropical Agriculturist*, September, 1901.
5. E.S.W. Senathi Rajah—"Agricultural Banks for Ceylon". *Tropical Agriculturist*, August, 1906.
6. The idea of an Agricultural Society was not new to Ceylon. As early as 1842 the Agricultural Society of Ceylon was established with the Governor as Patron and the Colonial Secretary as President. However, that Society does not appear to have functioned after 1844.

advancement of agriculture, especially non-plantation agriculture, by the improvement of techniques and other means. The Society acquired control of the *Tropical Agriculturist*[7] and its counterparts the *Govikam Sangarawa* in Sinhalese and the *Kamat Tholil Vallakam* in Tamil, which became its official organs in the three languages. The Society began the first systematic effort to study the problems of the small farmer. It was soon realised that proper credit facilities were an essential pre-requisite for the improvement of indigenous farming[8]. Meanwhile the situation in the neighbouring sub-continent of India had been studied by Sir Frederick Nicholson in his report of 1895 on the possibility of introducing land and agricultural banks in the Madras Presidency. On his recommendation the Indian Co-operative Credit Societies Act of 1904 had been enacted. These developments in India too served to underline the need for similar steps in Ceylon. The Agricultural Society, therefore, launched a campaign for the introduction of a system of agricultural credit in Ceylon. The *Tropical Agriculturist* scoured foreign journals for articles on co-operation and reproduced them in its volumes. Members of the Society were encouraged to study the problems of credit; there was a spate of papers on the subject read at meetings of the branch societies. The attitude of the Society and its members was summed up editorially as follows:— "Articles dealing with the working of Co-operative Societies in other countries have been given in many numbers, and we shall not let this subject drop till it is in a fair way of being taken up more thoroughly in Ceylon"[9].

In fact, almost every month the Journal carried articles on some aspect of co-operation especially in foreign countries. The general theme of the articles was to show the benefits arising from agricultural co-operation, especially, co-operative credit. The campaign was essentially directed towards the establishment of

7. The *Tropical Agriculturist* was a journal started by Mr. J. Ferguson in 1883. Its columns were devoted to information on all aspects of tropical agriculture. It had a wide circulation both within and outside Ceylon and discussed problems of agriculture in Ceylon and other countries. The publication was privately managed until 1904 when the Ceylon Agricultural Society took it over. After 1912 it became the official organ of the Government Department of Agriculture.

8. At the very first meeting of the Society Dr. J.C. Willis, Director of the Royal Botanic Gardens, Peradeniya, emphasised this point in his paper entitled "Co-operative credit Societies and Co-operative Agricultural experiments".

9. Editorial "Co-operation in Agriculture", *Tropical Agriculturist*, May 1907.

co-operative credit; it did not concern itself with the broader field of agricultural credit, except for a few isolated articles on the broader aspects.

In 1906 under the aegis of the local agricultural society, the first[10] co-operative credit society was started in Dumbara. Over Rs. 1,000 were subscribed by 66 shareholders. The rules were based on the Bengal Societies. The main object was to issue seed paddy to cultivators, at a low rate of interest, 12 per cent. Inspired by this pioneer effort the local agricultural societies at Telijjawila and Vavuniya also made proposals for the formation of similar societies. The Telijjawila Co-operative Credit Society for the purpose of distributing seed paddy at 25 per cent interest and the Vavuniya Forwarding Agency for providing markets and information to local cultivators were formed in 1907. Another society was formed in Baddegama for the issue of manure to cultivators. These co-operative societies were very small; they were established for very restricted purposes and not to tackle the broader problems of agricultural credit.

Apparently, the inspiration did not spread to other areas. Those few societies were themselves heavily dependent on the leadership provided by a few local enthusiasts. Possibly such leadership was not forthcoming in other areas. Whatever the reasons may have been, there was little hopeful evidence at that stage of the spontaneous growth of a co-operative credit system in Ceylon.

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10. This was the first society to be modelled on strictly co-operative principles. Societies of a co-operative nature appear to have existed earlier in Ceylon as is evidenced by the following remarks in the *Sinhala Samaya* (a Sinhalese newspaper). (The extract is from a translation which appeared in the *Tropical Agriculturist*, January 1906). "We know that much benefit was derived by the neighbouring villagers from such a society started in Heenatigale, Galle, about 25 years ago. The whole society (Bank) was divided into shares, and each share contributed 50 cents a month for 7 years. A shareholder had the privilege of taking loans on low interest. The funds of the society were given on interest even to the general public on security. At the end of seven years the accumulated amount in the said society, together with the profits, was divided among the shareholders according to their shares. In this manner a new society was formed and conducted as before for a fresh period of seven years. There is another form of village bank societies in the Southern Province with respect to coconut trees. Owners of coconut lands meet and fix the value of produce from their respective lands, allot them into shares for a fixed number of years, form a Society, and fund the income derived from such lands after they have been protected and looked after by the Society. The funds of the Society are also lent to members on low interest and at the expiration of the period for which the Society was started, the members divide the accumulated funds among themselves. Although such societies are conducted in this country, since some time past, their progress is hindered for want of sympathy of the Government . . . .".

Nevertheless, initially, the official attitude was based on the hope that when the felt need arises there would be a spontaneous growth of co-operative credit societies[11]. Sir Henry Blake was positively opposed to the establishment of any Government sponsored credit institutions. His term of office ended in 1907. His successor, Sir Henry MacCallum held a more flexible view. He called up annual Durbars of native chiefs to discuss the problems of the small farmers. At the Durbars held in 1908[12] he raised the question of high interest rates on loans of seed paddy. The proceedings of the Durbars illustrated, *inter alia*, a salient problem in rural Ceylon, namely, the lack of leadership. While a foreign Governor was sponsoring the cause of the peasants, the native chiefs, their acknowledged leaders, showed little enthusiasm and some of them objected to any ameliorative schemes. Perhaps, the failure or reluctance of the leaders to grasp the genuine needs of the peasantry was one of the most important reasons why co-operative societies failed to be established spontaneously at that time.

Meanwhile, the Legislative Council had passed a resolution[13] "that the Government do call on each Agent or Assistant Agent for a special report on the present condition of rice cultivation in his Province or District, together with a statement of any hindrance to, and how best to secure the extension of, this important native industry". The resulting reports[14] drew attention to the various problems facing paddy cultivation; and pointed reference was made to the need for suitable credit facilities and the need to prohibit high rates of interest. The Governor was, apparently, alarmed by the conditions portrayed in the Agents' reports. He therefore included an item of Rs. 2 million for "loans to native Agriculturists" under "Services proposed to be charged to Loan and Surplus Balances, 1908"[15]. He proposed to advance to the cultivator, at reasonable rates of interest and on the security of his land and crops, his seed

11. See paper read by Sir Henry Blake, in 1907, before the Royal Colonial Institute, reproduced in the *Tropical Agriculturist*, February 1908, "Sir Henry Blake on native agriculture and the Ceylon Agricultural Society".
12. Durbar of Native chiefs (Kandy) May 1908—SP XVIII of 1908. Durbar of Native chiefs (Colombo) July 1908—S.P. XIV of 1908.
13. Resolution on a motion by the Hon. J. Ferguson on 11.2.1907.
14. *Rice cultivation in Ceylon.* S.P. VI of 1908.
15. *Correspondence connected with services proposed to be charged to Loan and Surplus Balances*, 1908. S.P. XLII of 1908. Despatch from the Governor, Sir H.E. MacCallum to the Rt. Hon. the Earl of Crewe, K.G. dated 2.7.1908.

paddy, agricultural implements, manure, bulls for ploughing, and fencing. The advances were to be given not to individual cultivators but to groups of cultivators under a scheme similar to that then in operation in the United Provinces of Agra and Oudh in India. He outlined the administrative details of his scheme. The Secretary of State for the Colonies did not favour the proposal. He replied, "I am in sympathy with the object you have in view, and I am prepared to approve the principle of the scheme, but I do not consider it proper to set apart loan funds for such a purpose. If the measure is to be successful it must be worked cautiously, on a small scale at first, and the funds should be provided, within the limits laid down, from surplus balances as available. The regulations under which it is proposed to work should be submitted for my approval before any loans are actually made"[16]. The scheme was never implemented. Nevertheless, the Governor's interest in the subject continued. He suggested to the Agricultural Society to invite papers on the subject from the public. He also raised the question at the three Durbars held in 1909. Thus the official attitude towards the campaign for agricultural credit changed substantially after Sir Henry MacCallum became Governor. His scheme for direct aid to native agriculturists did not receive the whole-hearted support of the Colonial Office. He, therefore, turned his attention to the possibility of establishing a system of co-operative credit; in fact, he undertook to formulate a scheme for the purpose. However, he soon realised the formidable nature of the task and decided to entrust the work to a Committee.

The Agricultural Banks Committee, 1909

In 1909, the Governor appointed a Committee "to consider the whole question of Agricultural Banks: whether they are required in Ceylon, and how far Banks, on the models introduced in India, are suited to the conditions now existing in Ceylon". He also wrote a memorandum to the Committee in which he asked the Committee to inquire into "The conditions presently existing in Ceylon between the agricultural landlord and his tenant; how far the customary terms are fair and equitable to the tenant, whether his state of indebtedness was temporary or otherwise; and whether he stands in need of assistance, and if so, to what extent and in what form".

16. Ibid. Despatch dated 11.9.1908 from the Rt. Hon. the Earl of Crewe to Sir H.E. MacCallum.

The Committee had a wide mandate "to consider the whole question of Agricultural Banks". They had before them a rich heritage of literature on the subject. This literature had stressed a number of aspects of the problem. First, there was general agreement that the small farmer was in debt either to his landlord or to money-lenders. In either case, the rate of interest, in cash or kind, was high. Secondly, it was also realised that the farmer could not undertake any agricultural improvements without capital. Thirdly, co-operative credit societies had been widely recommended as the ideal remedy although there was a minority of persons who thought that co-operative credit though necessary was insufficient for the needs of the small farmer. The members of the Committee would have been quite familiar with this background knowledge since they were members of the Agricultural Society which had been instrumental in drawing attention to the needs of the small farmer.

The Committee,[17] however, appears to have been inhibited by the Governor's memorandum, especially the part quoted above. They devoted their attention primarily to three questions, namely

(i) the relationship between landlord and tenant,

(ii) the indebtedness of the cultivator; and

(iii) whether he stands in need of assistance, and if so, in what form.

They considered the question of Agricultural Banks only in so far as it was relevant to question (iii).

On the question of relationship between landlord and tenant the Committee was of opinion "that the relations of the landlord and cultivator in Ceylon today are on the whole fair and equitable; there appears little reason to suppose that the tenant is at present—or is likely to be—oppressed by the landlord".

On the question of indebtedness the majority of the Committee considered that "most of the villagers in Ceylon today are indebted —they are not oppressed by the landlords but by the moneylenders; the very fact that the villager is often a landowner himself adds to the burden of his indebtedness, for he has no capital. He is obliged to buy his money dear and sell his produce cheap. The villager

17. The report of the Committee was published as S.P. VII of 1910. *Agricultural Banks.*

depends on his crop for his food supply, and has no money for his other requirements, usually at present unproductive expenditure on weddings and funerals". They thought that the villagers did not usually borrow for agricultural purposes. These findings were not supported by any statistical data; they were based on the general impressions of members and witnesses, none of whom were small farmers. One member of the Committee was of opinion that the villager was not in debt for no one would lend to him and thus he buys from boutiques and settles up. He went on to recommend that "For the protection of these and indeed all classes of the native population there should . . . be legislation for the registration and proper control of professional moneylenders and the regulation of conditions attaching to their operation". This aspect of the matter does not appear to have interested the other members.

To the third question they answered that "Co-operative credit societies, if they can be established, would be of great value and benefit to the villager, enabling him to borrow at a reasonable rate of interest for his agricultural needs, while offering him an inducement to invest money in his land, in manures, improved agricultural machinery and etc., all of which would give him a return more than commensurate with the expenditure incurred". They were aware of the difficulties of establishing co-operative societies because the villagers left to themselves were unlikely to organise such societies, being ignorant of co-operative principles. They recommended that legislation on the lines of the Co-operative Credit Societies Act No. X of 1904 of India should be enacted in Ceylon. They recognised that the mere enactment of legislation was insufficient; the Agricultural Society was to be entrusted with the task of enthusing the people by means of propaganda through leaflets and lectures; Government officers were to encourage the formation of societies; and, fiscal and administrative privileges, similar to those granted in India, such as, exemption from stamp duty and Government audit of accounts, were to be granted to the Societies. They were opposed to direct Government participation because the co-operative principle would then never be established. Financial aid to each co-operative society was to be limited to Rs. 500 or the equivalent of the members' subscription, whichever was lower. Those, in brief, were the main recommendations of the Committee. They were not designed to meet the very high expectations which the committee placed on co-operative credit. The financial aid was singularly inadequate to meet the needs of a developing peasantry. The entire scheme was inspired by and modelled on the Indian Act. They made no provision for a staff of field organisers; instead, they entrusted the task to an unofficial body, the Agricultural Society. Indeed, the dissenting member thought that the Committee had even gone too far; he was content with only having a Co-operative Credit Societies Act on the Statute Book. In fairness to him, it must be stated that he thought that small scale paddy cultivation was not economic and that the villager should be weaned away from his old associations and encouraged to seek employment in plantations.

The Committee did not consider "the whole question of Agricultural Banks". They recommended the then fashionable panacea for all ills of small farmers, namely, co-operative credit. They expected such societies to finance all, including capital, needs of the farmer; but they made inadequate financial provision for the purpose. They did not give full consideration to the major problem of providing capital for the improvement of peasant agriculture, a problem which had been repeatedly urged in the literature of the preceding five years. Of course, the evidence of witnesses was singularly devoid of any constructive suggestions and some witnesses even denied the need for credit facilities. Nevertheless, the Committee had a wide mandate, which they failed to utilise to the fullest possible extent.

The recommendations of the Committee resulted in the enactment of the Co-operative Credit Societies Ordinance No. 7 of 1911. Whatever its deficiencies, that legislation marked the beginning of organised agricultural credit facilities for the small farmer in Ceylon.

The Growth of the Co-operative Movement

Although the Ordinance was passed in 1911, there was no immediate administrative provision to execute it. Until 1913, the Registrar General was also the Registrar of Co-operative Societies. In 1913, the Director of Agriculture was appointed as Registrar of Co-operative Societies and a Board of Control[18] was appointed to

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18. The Board of Control consisted of the Hon. Treasurer as Chairman, the Government Agents of the Western and Central Provinces and the Registrar of Co-operative Societies.

regulate the Government loans to societies. The Director of Agriculture had his own field staff of Instructors; the organisation and control of co-operatives societies was added to their other duties.

The first conference of co-operative societies was held in Kandy in April 1914. There were 37 societies at the time with a total membership of nearly 2,000. At the conference the question of financing primary co-operative societies was raised; it led to the appointment of a committee to report on the advisability of establishing a fund for the purpose. On the recommendation of the Committee,[19] the Local Loans and Development Fund was established by Government for the purpose of making loans to public bodies, co-operative credit societies, co-operative industrial societies, and Government officers for building houses for their own residence. Under the rules of the Fund the co-operative societies were entitled to borrow up to the amount of their paid-up share capital; the rate of interest was 4½ to 5 per cent per annum; and repayment was spread over ten years in annual instalments[20].

The original Co-operative Ordinance, as its title suggests, made provision only for primary credit societies. Non-credit and secondary societies were not provided for. A decade of experience had also necessitated various other amendments. Consequently, in 1922, a new Ordinance, the Co-operative Societies Ordinance No. 34 of 1922 was enacted. The borrowing powers of societies were also increased. Credit societies with unlimited liability were permitted to borrow up to three times their paid up capital and reserves; credit societies with limited liability were allowed to borrow up to the equivalent of their paid up share capital and reserves. Special provision was also made to lend up to Rs. 2,000 to societies in certain backward areas irrespective of the share capital. Meanwhile, in 1917, the repayment provision had also been altered so that repayment commenced only two years after the grant of a loan.

19. Report published as S.P. XVII of 1914.

20. It is seen that from the very inception Co-operative Credit Societies were able to borrow at low rates; such facilities were not extended to private moneylenders to whom the opportunity cost of their capital, as will be explained in Chapter VIII is likely to be rather high.

The administration of the movement was still in the hands of the Director of Agriculture. A memorandum[21] written in 1924, recommended the appointment of a Joint Registrar to supervise the movement and the study of Indian Central Banks with a view to establishing similar institutions in Ceylon. In the following year, a civil servant was specially deputed to study the working of co-operative societies in India and certain European countries. At the end of his study tour the officer made two reports. The first[22] was concerned with a discussion of the co-operative institutions in the various countries which he had visited. The second report[23] referred specifically to the problems of co-operation in Ceylon. He referred in detail to the various defects of the movement, namely—

1. They were started with inadequate education; the members were unaware of the principles of co-operation.
2. They were left without adequate supervision because, until 1926, co-operation was run by a totally inadequate staff, supervised by officers whose primary interests were with the Agricultural Department.
3. Each Society covered too wide an area; this was incompatible with mutual knowledge of members, an essential factor of the unlimited liability principle.
4. The finances of the Societies were inadequate; the existing rules about borrowing limits, whereby each society is authorised to borrow up to three times the paid-up share capital plus reserves, implies that there is some relation between the share capital and security for the loans. This is wrong because the real security is the material wealth owned by all the members of the society and pledged jointly under the principle of unlimited liability.

He recommended the establishment of a separate department. He was, himself, appointed Joint Registrar in 1926 and as sole Registrar in 1930, when a new Department of the Registrar of

21. *Memorandum on the further development of the co-operative movement in Ceylon*, S.P. XXIV of 1924.
22. *Report on Studies in Co-operation*, S.P. XXIV of 1926 by W.K.H. Campbell, C.C.S.
23. *Supplementary Report on Co-operation in Ceylon*, S.P. XXXI of 1927 by W.K.H. Campbell, C.C.S.

Co-operative Societies was established. This arrangement continued until 1945 when a new Department of the Commissioner of Co-operative Development was created to undertake the general planning and direction of the movement as well as to handle any undertakings of an extraordinary nature, like the Co-operative Wholesale Establishment. The Registrar was entrusted with supervision, audit, education, propaganda and the organisation of new societies. The division of functions was only internal and both departments functioned under a single head. The separation of functions was only a temporary expedient; today there is a single Co-operative Department with a specialised staff of over 1,300 officers. Such, in brief, is the development of the official wing of the co-operative movement in Ceylon.

Table I shows the growth of the movement itself. Initially it was essentially a credit movement. As the data for 1920 and 1939 show, there were few other types of societies before 1939. In fact, until 1942 credit was the primary sphere of activity of the Ceylon co-operative movement. Among credit societies too the society with unlimited liability, which is the type operating in rural areas, was of predominant importance.

After 1942, however, the structure of the co-operative movement has undergone marked changes. It has become an agent of Government economic policy. The war-time shortage of consumer goods led to a scheme of price control and rationing; the co-operatives were used by Government as a medium of distribution under the rationing scheme. An intensive campaign of organising retail stores societies was launched and, as the figures for 1945 indicate, they became the most important type. At the end of 1945, the retail societies accounted for 63 per cent of the total number of societies, 91 per cent of the total membership and 58 per cent of the working capital of the entire movement.

Between 1945 and 1955, the emphasis in the movement has changed once again. The unlimited liability credit society of the rural areas has the largest number of societies but it is by no means the predominant activity. Its membership and working capital are comparatively small although they have expanded since 1945. The retail societies still have the largest membership but the largest working capital is held by the marketing and production

TABLE I

Growth of the Ceylon Co-operative Movement

TYPE OF SOCIETY	1920 (*a*)			1939 (*a*)			1945 (*a*)			1955 (*b*)		
	No. of Societies	Membership	Working Capital (Rs'000)	No. of Societies	Membership	Working Capital (Rs'000)	No. of Societies	Membership	Working Capital (Rs'000)	No. of Societies	Membership	Working Capital (Rs'000)
Credit—Unlimited liability	132	14,883	(*c*)	1,201	30,957	1,726	1,697	49,638	2,777	3,145	102,907	9,329
Credit—Limited liability	4	327	(*c*)	78	3,136	348	114	4,789	710	147	12,684	2,993
Thrift Societies	—	—	—	104	14,912	1,216	195	17,009	2,045	385	55,956	9,902
Land Mortgage Banks	—	—	—	1	(*d*)	(*d*)	1	(*d*)	(*d*)	2	68	8
Marketing and Production	—	—	—	(*d*)	(*d*)	(*d*)	160	15,387	(*d*)	1,668	262,367	34,397
Retail Stores	—	—	—	24	11,584	142	4,004	1,010,575	15,188	2,720	724,940	15,582
Other types	—	—	—	50	4,500	316	97	3,931	2,327	1,492	1,44,703	6,254
Total Primary Societies	**136**	**15,210**	**146**	**1,458**	**64,691**	**3,748**	**6,268**	**1,101,329**	**23,047**	**9,558**	**1,303,625**	**78,465**
Secondary Societies, Unions and Banks	—	—	—	54	1,806	991	115	5,244	3,000	256	16,366	47,347

(*a*) As at 30th April.
(*b*) As at 31st December 1955.
(*c*) Not separately classified.
(*d*) Not separately classified, presumably included in other types.
Source:—Administration Reports on the Working of Co-operative Societies for 1919-20, 1938-39, 1942-45 *and* 1955.

societies. The greatest expansion, since 1945, has also been in this type of society. This, again, is due to the fact that the Government has used the co-operative movement to further its economic policies. A new type, the Co-operative Agricultural Production and Sales Society, was started in 1947 in order to implement the Food Production Drive of the Government. This led to the rapid expansion in the marketing and production societies. The number and membership of retail societies has actually fallen as a result of the liquidation of a number of unsatisfactory mushroom societies started during the war emergency.

One important aspect of the growth of co-operatives is the comparative insignificance of the land mortgage bank. Up to 1945 there was only one bank, since then another has come into existence. The total membership is only 68 and the working capital only Rs. 8,000. The reasons for the lack of development in this branch will be discussed subsequently.

The structure and organisation of the co-operative movement

The co-operative movement, as organised at present in Ceylon, consists of a variety of primary and secondary societies. Their functions are varied and they impinge on the rural economy at different stages of production and distribution. From the point of view of agricultural credit, they may be classified as follows:—

(*a*) non-credit, non-agricultural societies,

(*b*) consumer retail societies,

(*c*) non-agricultural credit societies; and

(*d*) agricultural production, marketing and credit societies.

The above classification is somewhat arbitrary and cuts through the classification into types usually adopted in the *Administration reports on the working of co-operative societies*. The rationale of this classification is that it makes it possible to select for detailed discussion only those types which are directly relevant to the problems of agricultural credit. The classification arranges the societies in ascending order of proximity to the subject of agricultural credit.

The *first* group consists of societies whose functions are non-agricultural and non-credit. They are not relevant to the problems of agricultural credit and hence will not be discussed.

The *second* group consists of Consumer Retail Societies which operate both in rural and in urban areas. At the end of 1955, there were 2,720 societies of which 2,224 were in rural areas. The total membership of the rural societies was 520,166. The societies operate retail stores for the benefit of the members who would otherwise have depended on the village boutique-keeper. Originally, the majority of these societies were formed for the purpose of distributing rationed goods during the war. They were established under Government initiative. They were successful during the war due to the patronage extended by Government, the shortage of supplies elsewhere and the consequent stifling of competition from the private trade, and the availability of ready cash in the hands of their members owing to war-time prosperity. Rationing of all commodities, other than rice, has now been given up. Competition from private trade has grown steadily while members no longer possess ready cash to pay for their purchases. The sheltered conditions in which the retail co-operatives functioned have ceased to exist. Consequently, in the post-war period, a number of the weaker societies have been compulsorily liquidated. The number of societies fell from 4,004 in 1945 to 2,720 in 1955 despite the formation of new societies during the period. The reduction in the number of societies has been partly due to the policy of consolidating the consumer retail movement. Under this policy the inefficient societies are wound up and their business transferred to neighbouring societies. Nevertheless, it goes to show that, under conditions of normal trading, some co-operative retail societies have not been able to withstand the competition of the private trader. The inability of co-operative retail societies to function efficiently under normal trading conditions must partly be due to the fact that they do not sell on credit.

The co-operatives do not allow credit purchases by members; they sell goods only for immediate cash. Unless the farmer has a continuous supply of cash or some source of credit he cannot always buy his goods from the co-operative society. Farm incomes are seasonal and notoriously discontinuous; nor are satisfactory sources of credit available. Consequently, the village boutique-keeper continues to co-exist with the consumer co-operative society. They exist simply because they sell two different types of goods, the one on credit, the other for cash. The consumer co-operative cannot expect to capture the full custom of its members unless it offers the real type of transaction for which demand exists in the villages, namely, the sale of consumer goods on credit. The role which the societies can play, as they are presently constituted, is essentially very limited because they do not sell goods on credit.

The *third* group consists of fishermen's credit societies, thrift societies, cottage industrial societies, limited liability credit societies. Of these the fishermen's credit society is not relevant to the present subject. Thrift societies are popular among salary earners who use them to save regularly a part of their salaries and to borrow on the security of their savings. The primary purpose of a thrift society is to encourage saving by its members and to grant loans to them for urgent purposes. At the end of 1955, there were 385 thrift societies with a membership of 55,956.

The limited liability credit societies operate in urban areas; they are, in fact, generally known as urban credit societies. The liability of members is limited as in an ordinary joint-stock company. They are modelled on the Schultze-Delitsch Societies of Germany.

These societies lend mainly for trade, repayment of old debts and medical purposes. Although the thrift societies and the urban credit societies operate in urban areas, some of their members borrow for agricultural purposes as well. The table below shows the purposes for which loans have been granted by these societies from 1953–1955. Some of the loans, such as those for the purchase of land, may be for non-agricultural purposes. The total of possibly

TABLE II

Purpose of Loans—Co-operative Credit (Limited) and Thrift Societies. 1953-1955

Purpose	*Credit limited societies* No. of loans	*Credit limited societies* Amount (*Rs.* '000)	*Thrift Societies* No. of loans	*Thrift Societies* Amount (*Rs.* '000)
Cultivation	1675	322.0	932	97.0
Buying of cattle	232	44.7	180	21.7
Purchase of land	407	191.3	370	145.7
Improvement and lease of land ..	566	120.8	1443	89.4
All other purposes	19522	4349.7	88491	6585.3
Total ..	22402	5028.5	91416	6939.1

Source:—Calculated from the *Administration reports on the working of Co-operative Societies*, 1953 to 1955.

agricultural loans was less than 5 per cent and 14 per cent of total loans granted by thrift societies and credit (limited) societies respectively during this period. Thus, lending for agriculture is only an incidental activity of such societies. Nevertheless, in so far as they lend any money at all for agricultural purposes they are relevant to the subject of agricultural credit.

At the end of 1955, there were 568 cottage industrial societies with a total membership of 19,453. The societies, with the aid of the Government Cottage Industries Department, attempt to handle the marketing of cottage industrial products. The societies also grant loans to their members. The loans granted and the repayments made in 1955 are shown in Table III. Comparable data for earlier years have not been published. In some areas in Ceylon small farmers engage in cottage industries as a subsidiary occupation. To the extent that these societies supply a part of the total credit needs of such farmers their activities are relevant to the problem of agricultural credit.

TABLE III

Loans granted by Cottage Industrial Societies to members in 1955

	Amount lent (Rs.)	*Amount repaid (Rs.)*
1. Short-term		
(*a*) for purchase of raw materials	184,492	116,110
(*b*) for marketing	6,500	4,510
2. Medium-term for purchase of equipment and machinery	154,593	145,101
3. Long-term for construction of buildings and purchase of land	119,000	7,630
Total ..	469,585	273,351

Source:—Administration Report on the Working of Co-operative Societies, 1955.

The *fourth* group is the category that is directly concerned with the supply of agricultural credit. For the purpose of discussing, in detail, their organisation and function they will be sub-classified as follows:—

(i) marketing and production societies;
(ii) co-operative agricultural production and sales societies;
(iii) co-operative credit societies; and
(iv) land mortgage banks.

The first two types overlap somewhat but the justification for their separate treatment is that the second is a special type created for special purposes.

1—Marketing and Production Societies

The following are included under this heading:—

Name of type of Society	*No. of societies at end of* 1955
Jaffna Malayalam Tobacco Co-operative Sales Society	1
Valigamam East Co-operative Plantain Sales Society	1
The Northern Division Agricultural Producers' Co-operative Union	1
Coconut Producers' Societies	33
Rubber Producers' Societies	12
Tea Small-holders' Societies	19

The Jaffna Malayalam Tobacco Co-operative Sales Society operates among the tobacco growers in the Jaffna District. It exists for the purpose of marketing tobacco crops of its members. The market for the tobacco is in the Travancore-Cochin area of India and the conditions of sale of tobacco are governed by an Indo-Ceylon Agreement. The society purchases the crops of members by paying an advance. After the disposal of the crops the members are paid a further rebate depending on the prices for which the society was able to sell the tobacco. The Valigamam East Co-operative Plantain Society performs similar functions among the plantain (banana) growers of the area. The Northern Division Agricultural Producers' Union has 44 member societies affiliated to it. These societies purchase produce from their members. The products include paddy, bran, chillies, onions, tomato and plantains. These three societies operating in the Northern Province are essentially marketing societies organised among small farmers.

The Coconut Producers' Societies are also marketing organisations operating among small producers in the coconut belt of the North-Western and Western Provinces. The small producers of coconut, some of them with very small holdings of under 10 acres in extent, cannot undertake economically the processing of the fresh nuts into copra, oil or dessicated coconut because of the capital involved. Some of the Producers' Societies, thirteen at the end of 1955, have their own processing mills which pool for processing purposes the small crops of their members. The Societies sold Rs. 15.6 million and Rs. 13.6 million worth of coconut products in 1954 and 1955 respectively. There were 33 Societies, at the end of 1955, with a total membership of 8,092 and a working capital of Rs. 7.4 million. The members among them owned slightly under 100,000 acres of coconut. Altogether there are nearly 600,000 acres under small holdings in coconut, only about a sixth of them have co-operative producer societies.

There are two types of societies among rubber producers. The first type, of which there were 5 with a membership of 585 at the end of 1955, operate in rubber estates acquired by Government. These estates are really co-operative settlements in which the land is blocked out among several small-holders. They pool their resources for the purpose of processing and marketing. In 1954 and 1955 they sold Rs. 573.7 thousand and Rs. 669.8 thousand worth of rubber respectively. The other type of society, of which there were 7 with a membership of 411 at the end of 1955, operates among individual small holders in rural areas. They handle only the marketing of their members' crops. They are not widespread among rubber small holders; there are over 125,000 small holders of whom only 411 are members of such co-operatives.

There were 19 Tea Small-holders' Co-operative Societies with a membership of 3699 at the end of 1955. They too cover only a small fraction of tea small holders of whom there are about 87,000. The societies make loans for the improvement of holdings, supply manure, implements and insecticides and act as a medium for disbursing Government subsidies. The Government uses these societies to implement a scheme whereby the small holders are assisted in the following ways[24]:

1. Government pays one third of the cost of fertilizer supplied through a society; the other two-thirds is given as a short-term loan.

24. *Administrative Report of the Tea Controller*, Ceylon, 1955.

2. Government gives an outright grant of Rs. 20 per acre for contour draining and terracing to prevent soil erosion.
3. Government grants short-term loans of Rs. 30 per acre to help in the repayment of debts to factory owners.
4. Government assists in purchasing spraying equipment to provide anti-Blister-Blight measures.
5. A loan of Rs. 50 per acre is given to each Co-operative Society for the establishment of green-leaf collecting depots and for the purchase of weighing machines, vans and leaf bags.

One society has set up a factory for processing green-leaf. The scheme itself caters to some of the credit requirements of the tea small holders but its operation is limited to a handful of them who are members of the societies.

One significant fact about the specialised marketing and production societies for tea, rubber and coconut is that few small holders are members despite the substantial benefits derived by members. There are a number of general reasons why the Co-operative movement itself has had limited success in Ceylon; they will be examined at the end of the chapter. Apart from such general reasons, there is a more specific reason why these special types have not been very popular. They are suitable only where there is a concentration of farmers specialising in the cultivation of one or other of the crops. The Coconut Producers' Societies have been established in the coconut belt of the North-Western and Western provinces where typical farmers specialise in the production of coconuts. Consequently, in those areas there are a sufficient number of persons with identical interests to form a society. In other areas, the small holder of coconut is engaged in a variety of other occupations like paddy cultivation, and non-agricultural occupations. As a result there is not that same identity of interest to draw them together into such a specialised society. The same reason applies in the case of rubber and tea. Moreover, these special types have been started only recently and have, as yet, had little time to expand. It can be expected that, given time, a greater proportion of small holders in each crop will become members.

II—Co-operative Agricultural Production and Sales Societies (C.A.P.S.)

Originally these societies were styled as Agricultural Produce Sales Societies and were a war-time Government agency for the purchase of local produce under the Internal Purchase Scheme. Since 1948 they have become the chief agency for conducting the Government's Food Production Drive. In their origins as well as in their present functions they are essentially a Government agency although organised on co-operative lines. They are a state-sponsored credit and marketing organisation subserving the Government policy of increasing food production within the country.

Between 1948 and 1955 the C.A.P.S. societies have expanded rapidly as Table IV shows. Despite this rapid expansion not all

TABLE IV

Growth of C.A.P.S. Societies

Date	*No. of Societies*	*No. of members*	*Working capital (Rs. million)*
30. 4.1948	193	23,165	5.9
30. 4.1949	309	47,779	9.4
30. 4.1950	459	73,680	14.2
31.12.1954	786	186,968	17.8
31.12.1955	842	217,123	20.4

Source:—Administration reports on the working of Co-operative Societies.

small farmers are members of these societies. At the end of 1955 there were only 217,123 members. This is partly because not all small farmers cultivate food products and partly because among food producers too the accent has, in practice, been towards enrolling paddy cultivators as members of these societies. More general reasons which apply to the co-operative movement as a whole too have retarded their growth; these reasons will be examined later.

The chief objects of the societies are to act as agents of the Director of Food Production[25] in financing the cultivators in their food production activities, and to act as agents of the Commissioner for Development of Marketing in purchasing produce under the Guaranteed Price Scheme.

25. Commissioner of Agrarian Services, since 1957.

The cultivation loans are all granted by Government. The loan procedure is somewhat complicated. There are District Agricultural Committees[26] which call for the programmes and estimates for each area for the coming cultivation season. At the village level these estimates are prepared by the subordinate officials of developmental departments on behalf of the C.A.P.S. societies. After the district programmes have been approved by the Department of Food Production the necessary funds are released through Co-operative Provincial Banks with which the C.A.P.S. societies maintain banking accounts.

The purposes for which loans may be granted are as follows:—

1. purchase of seed and planting material;
2. purchase of manure;
3. purchase of buffaloes, draught bulls, cows and poultry;
4. purchase of implements and irrigation pumps;
5. Asweddumization of paddy lands at the rate of Rs. 100 per acre up to a maximum of Rs. 500 per member;
6. construction of offices, go-downs, mills, etc.;
7. purchase of machinery;
8. purchase of vehicles for transporting produce;
9. marketing of agricultural produce; and
10. construction of wells.

In "surplus areas" cash loans are also granted to members for the following purposes:—

1. transplanting at the rate of Rs. 15 per acre up to a maximum of Rs. 75 per member;
2. reaping and threshing at the rate of Rs. 15 per acre up to a maximum of Rs. 75 per member;
3. preliminary cultivation expenses at the rate of Rs. 20 per acre up to a maximum of Rs. 100 per member; and
4. additional cash loans up to a maximum of Rs. 500 per member against the security of the standing crop. This is given only to members of societies which have demonstrated their business capacity and whose finances are sound.

26. The members of a District Agricultural Committee include the Government Agent of the District, the local Member of Parliament and representatives from the agricultural developmental departments, like the Agricultural, Irrigation, Food Production and Land Development Departments.

The cultivation requirements—like ploughs, barbed wire, manure, seed paddy—are given in kind on loan. Cash loans are provided for the purchase of buffaloes. Tractors are normally purchased by the Society out of Government loans and hired out to the cultivators. Once the crops ripen, marketing loans are granted in cash on the security of the standing crop. After the harvest the farmer obtains from the C.A.P.S. Society the full guaranteed value of the crops purchased from him less any advance already made to him.

The actual purposes for which loans have been issued by Government in 1954 and 1955 are shown in the table below. It will

TABLE V

Loans issued by Government through C.A.P.S. Societies 1954 and 1955

Purpose	*Amount* (*Rs.*) 1954	1955
Marketing	5,312,600	11,268,054
Purchase of paddy	485,044	152,235
Purchase of onions	—	3,582
Purchase of buffaloes	63,585	—
Purchase of manure	2,437,033	2,802,099
Purchase of transport	15,049	—
Purchase of tractors	30,937	12,000
Purchase of office equipment	10,638	675
Purchase of pumps	507,115	578,065
Purchase of cattle	36,250	85,550
Construction of stores	496,357	352,067
Construction of wells	51,600	19,000
Lease of paddy lands	—	—
Implements (issued in kind)	37,745	18,293
Barbed wire and staples	652,363	435,609
Harvesting	22,000	—
Transplanting and weeding	13,500	15,000
Cultivation	378,000	431,485
Seed materials	33,039	800
Purchase of weighing machine	2,414	540
Tractor ploughing	10,000	11,454
Wire netting	1,450	—
Insecticides	6,496	899
Tractor garages	2,000	—
Purchase of land	9,500	—
Reaping and threshing	3,900	—
Seed potatoes	129,747	—
Potato fertilizers	40,744	—
Asweddumization	34,000	36,875
Fencing	15,000	—
Cash loans development works	—	15,000
	10,838,106	16,239,282

Source:—Administration report on the working of Co-operative Societies, 1955.

be seen that some of the loans are granted to individual members while some are given to the societies themselves to provide the overhead facilities required by their members. Marketing accounts for the bulk of the loans while a fair proportion is also taken for the purchase of manure. Loans are not given for consumption purposes directly although some of the advances taken against standing crops by members would be utilised for consumption purposes. However, such advances are given only after the crop ripens. Between planting and the ripening of the crops the farmers do not get consumer loans from C.A.P.S. societies. Hence they would still have to fall back on private sources of credit or the rural co-operative credit societies for their consumption requirements.

The actual loans granted to members and the repayments are shown in the table below. The repayment position is rather unsatis-

TABLE IV

Loans and Repayments—C.A.P.S. Societies, Members. (Amounts in Rs. '000)

Year	*Loans granted*	*Loans repaid*	*Amount outstanding*	*Amount overdue*	*Overdues as % of outstanding*
1951	9,803	7,813	4,139	—	—
1952	6,440	4,398	5,637	1,483	26.3
1953	6,059	2,298	9,413	3,236	34.4
1954	4,249	3,735	—	—	48.0
1955	3,713	3,828	9,700	4,100	42.0

Source:—Administration reports on the working of Co-operative Societies.

factory. At the end of 1954, 48 per cent of outstanding loans were overdue, it had fallen to 42 per cent at the end of 1955. According to the Registrar of Co-operative Societies, the overdues are due partly to crop failure and partly "to the unbusinesslike habits to which cultivators have been trained through generations by traders who exploit their ignorance"[27].

27. The high proportion of overdues is further evidence of the high risks taken by lenders in the rural sector. The CAPS Societies are able to withstand the consequences of such high overdues because they can fall back on Government funds. The private lender whose capital is strictly limited and who does not have the backing of a benevolent Government will not be able to withstand such high overdues if he lends at the same rates as CAPS. He has to cover himself with high rates of interest.

The Government grants loans both for short and long periods depending on the purpose for which the loans are required. The usual time limits are as follows:—

Purpose	Time limit of loan
1. Cultivation, transplanting and weeding, reaping and threshing, marketing	6 months
2. Purchase of manure, barbed wire, insecticides, agricultural implements, seed, poultry and pigs	1 year
3. Purchase of weighing machines and office equipment, cattle and buffaloes	3 years
4. Purchase of irrigation pumps and digging of wells	5 years
5. Construction of stores and purchase of tractors by Societies	10 years

The long term loans are given to the societies. The members are given only medium and short-term loans.

Government loans to societies are made at 2 per cent interest per annum out of which the Co-operative Provincial Banks are given a commission of ½ per cent. The actual rate of interest received by Government on these loans is, therefore, only 1½ per cent per annum. This is a subsidised rate because Government itself borrows in the market at rates around 2½ to 4½ per cent. The societies lend to members at 4 per cent per annum which, incidentally, is the cheapest rate at which loans can be obtained in rural areas.

The financial position of C.A.P.S. Societies as at the end of 1955 is shown in their Balance Sheet below. It is seen that the owned capital of members is small in comparison to the total working capital of the societies. They are, as yet, heavily financed from borrowed funds, the bulk of which comes from Government. This is but to be expected because the entire scheme is an instrument of Government policy. That the societies are building up some reserves is a satisfactory feature but they are very far from being self-sufficient.

Balance Sheet of C.A.P.S. Societies as at 31.12.1955. (Rs. '000)

Owned capital			**Fixed Assets**		2422.9
Share capital	1649.5		Lands, buildings, machinery, etc.		900.7
Reserves	1841.9				
Undistributed profits	3007.5	6498.9			3323.7
			Investments		370.4
Deposits			Value of stock		3559.3
Members	230.8		**Loans** due from		
Co-operatives	98.4		Individuals	9074·4	
Government	217.0		Societies and Unions	166.6	9241.0
Others	84.5	630.7	Cash in hand and Banks		5607.7
Loans from					
Provincial Banks	1236.4		Other assets		4842.6
Government	14553.4				
Others	486.1	16275.9			
Other liabilities		3539.2			
		26944.7			26944.7

Source:—Administration report on the working of Co-operative Societies, 1955.

To sum up, the C.A.P.S. societies are an agency of Government in its Food Production Drive and in the development of marketing. They have expanded rapidly in recent years though not all small farmers are members. They grant credit to their members only for approved cultivation and marketing purposes but not for consumption. The loans are for short and medium periods and are repayable with interest at 4 per cent per annum after 6 months to five years depending on the purpose of the loan. The Societies do not grant loans for periods longer than five years to their members.

III—Co-operative Credit Societies (unlimited liability)

These were the pioneer type of co-operative institution in Ceylon. They are modelled on the Raiffeisen Co-operative Societies of Germany. The chief characteristics of a Raiffeisen society are "unlimited liability, small area of operation, very small shares (a later development) no dividends or returns, building up capital by means of a reserve (to remain indivisible) and dealing only with members who produce proper security"[28]. The Societies in Ceylon differ from the model only in so far as they declare dividends based on the amount of business done by each member with the society. The principle of unlimited liability of members has been adhered to from the beginning. Shares tended to be comparatively large

28. F.A.O. *Co-operative thrift, credit and marketing in economically underdeveloped countries.*

until 1935, when the societies were completely re-organised on a truly Raiffeisen basis. The Committee members are not paid for their services; the reserves of societies have been gradually built up and the area of operation of each society is small.

The Co-operative Credit Society with unlimited liability, Rural Credit Society as it is called, is the largest single type of co-operative society in Ceylon. At the end of 1955, there were 3,145 societies with a total membership of 102,907. The IBRD mission[29] thought that there should be 5,000 credit societies in Ceylon. The total, at the end of 1955, including urban societies was only 3,292, well below the number recommended. The total membership of the Rural Credit Societies is also approximately only 10 per cent of the total number of small farmers in Ceylon. In fact, if the present average membership per society is to be maintained, the number of societies required by small farmers alone will work out to nearer 40,000 than the 5,000 recommended by the IBRD. The Rural Credit Societies, as organised at present cater to only about 10 per cent of all small farmers.

The table below shows the purposes for which they lend money to members. The bulk of the loans granted are for what may be called productive agricultural purposes. These would comprise loans

TABLE VII

Purpose of Loans—Rural Credit Societies, 1953-55. Total Loans 1953-55

Purpose	*No.*	*Amount* (*Rs.* '000)
Cultivation	115,965	14,127
Buying cattle	4,817	615
Purchase of land	2,112	302
Improvement and lease of land	11,900	1,328
Trade	27,782	3,131
Building of houses	5,745	763
Buying carts	1,460	180
Buying food	3,069	190
Medical	1,454	110
Payment of old debts	3,046	458
Ceremonial	302	36
Other	9,967	1,043
Total	187,619	22,283

Source:—Administration reports on the working of Co-operative Societies, 1953 *to* 1955.

29. IBRD. *The economic development of Ceylon.*

for cultivation, buying cattle, purchase of land, improvement and lease of land. Together they accounted for 70 per cent of the number of loans and 73 per cent of the amount of loans granted during the three years. This is in marked contrast to the pattern of debt revealed in Chapter III. There it was shown that 17.1 per cent of the total debts in 1950-51 were for these productive agricultural purposes. The pattern of annual borrowing would of course, be different from the pattern of outstanding debt at any particular date. Nevertheless, the wide difference between 17.1 per cent in the one case and 73 per cent in the other does give rise to a strong suspicion that these societies cater more to the strictly productive agricultural demand for credit than to other purposes. Also, the purchase of food and medical purposes accounted for 29.1 per cent of the total debts in 1950-51, whereas, the total loans granted by the Rural Credit Societies for the same purposes accounted for under 2 per cent of all loans. It would seem that the societies prefer to lend for productive purposes rather than for consumption. Indeed it would be a good thing to lend for productive purposes but, in the absence of any other suitable source of consumer credit, it would be a primary function of these societies to bridge the gap. They appear to fail in that very vital role.

The societies normally grant loans only for periods upto one year or eighteen months. They are essentially short term loans granted for the duration of a single cultivation season. As early as 1942, some of the better societies were permitted to lend for medium periods from 2 to 5 years but in the words of the Registrar—"these have made headway only in the Northern Province . . . [30] Despite the experience of the Jaffna District societies, the practice has not spread to other areas. In 1955, five societies, all in the Jaffna District, granted loans amounting to Rs. 18,448 a rather insignificant fraction of total loans granted by co-operative credit societies. Consequently, for all practical purposes, these societies lend only short-term loans.

The security for loans is personal. In this respect the societies overcome one of the serious obstacles to the flow of credit to rural areas, namely, the lack of suitable security. Lending on personal security requires intimate knowledge of the credit-worthiness of

30. *Administration Report* 1950-51.

the borrower. It is for this reason that Raiffeisen Societies are organised among a small compact group of people well known to one another. The liability of members is unlimited; the society itself borrows on the joint responsibility of all its members. A lender to a society has greater security than in lending to any individual member. The societies lend to members on personal security supported by two sureties. Apart from difficulties arising out of depressed rubber prices in 1920 and again during the general depression of the 'thirties, societies have not experienced much difficulty in recovery of loans. In particular years unforeseen calamities like floods or drought leading to crop failure have resulted in heavy overdues but they have normally been repaid with the return of better conditions. Both in 1954 and in 1955, 21 per cent of outstanding loans were overdue. In the early formative years there were some losses due to persistent default in repayment,[31] but with more experience the position appears to have improved. The comment of the Registrar in his report for 1955 was "2,322 Societies made profits . . . . whilst 725 Societies made losses. Most of the losses would be recouped on recovery of overdues of interest".[32] The principle of lending on personal security can fairly be said to have been vindicated by the experience of the Ceylon Societies.

The rates of interest charged by the Societies vary from 6 per cent to 9 per cent per annum. Many of the older credit societies lend at 6 per cent. These rates are low in comparison to those charged by private moneylenders in rural areas. It is, of course, relevant that the private moneylender cannot obtain funds on the same advantageous terms at which the co-operatives obtain money.

The primary societies obtain their funds mainly from within the co-operative movement as the Balance Sheet below shows. The Societies, as a whole are lending money which belongs to their own shareholders and the Co-operative Provincial Banks which themselves obtain under 5 per cent of their funds from Government. This is a far cry from the situation at the beginning when practically all their funds were obtained from Government through the Local Loans and Development Fund. In fact, the societies can borrow

31. W.K.H. Campbell, C.C.S. *Supplementary Report on Co-operation*, S.P. XXXI of 1927, p. 3.

32. See p. 15 of Report.

up to three times their share capital and reserves from the Local Loans and Development Fund. This means that Rural Credit Societies have more than Rs. 11 million of unused lending capacity on account of funds available from that source alone.

Balance Sheet of Rural Credit Societies as at 31.12.55. (Rs. '000)

Owned Capital			**Fixed Assets**		
Share capital	1423.0		Land and buildings	17.8	
Reserves	2391.6		Equipment, plant etc.	38.3	56.1
Undistributed Profits	2.3		Investments		462.9
Less losses	**29.9**	3787.5	**Loans due** from		
Deposits			Members	7561.9	
Members	2155.7		Societies and Unions	2.3	7564.2
Co-op. institutions	124.9		Cash in hand and Bank		1195.3
Others	**152.0**	2432.6	Other assets		77.1
Loans from					
Provincial Bank	3062.5				
Government	3.3				
Others	16.0	3081.8			
Other liabilities		53.5			
		9355.4			9355.4

Source:—Administration report on the working of Co-operative Societies, 1955.

To sum up, the Credit Society is the largest single type of co-operative institution in Ceylon. Yet only about a tenth of small farmers are members. Although they grant loans for almost any purpose, they seem to fight shy of consumption loans. The loans are granted for short periods and carry rates of interest varying between 6 and 9 per cent per annum. They also possess considerable excess lending capacity which would probably have been utilised had their lending policies been less stringent, i.e. if they lend more for consumer purposes.

IV—Land Mortgage Banks

This type has made very little headway in Ceylon. The pioneer Bank, started in Negombo in the early 'thirties, has remained practically dormant. There is now a second Bank at Kegalle. They have not been successful for a number of reasons. First, due to the lack of registration of title to land, there is little scope for small-scale mortgage lending. Secondly, they have not been able to obtain funds on their debentures from the public because the Government has persistently refused to guarantee their debentures in respect of capital and interest. Land Mortgage Banks have grown in India especially in Madras where the Government guarantees their debentures as in the case of the Madras Central Co-operative Land Mortgage Bank.

The two Banks operating in Ceylon have 68 members and a share capital of Rs. 4.9 thousand. The financial statement below shows the very small level at which they operate. They have no

Balance Sheet of Land Mortgage Banks, as at 31.12.55. (Rs. '000)

Share Capital	4.9	Cash in hand	5.4
Reserve	2.7	Investments	2.9
Undistributed profits ..	1.5	Loans due	0.8
	9.1		9.1

Source:—Administration report on the working of Co-operative Societies, 1955.

borrowed capital at all. They are holding the bulk of their funds in cash and investments. The actual loans outstanding are less than ten per cent of the available funds.

Secondary Finance

The sources from which the societies obtain their funds have been discussed under the various types of societies. Within the movement itself there are 11 Provincial Banks with a single apex Bank, the Co-operative Federal Bank of Ceylon, which is a Commercial Bank registered in Ceylon. The Provincial Banks obtain their loan funds from the Co-operative Federal Bank and Commercial Banks. The Federal Bank itself was commenced with an interest free loan of Rs. 2 million from Government in 1950. Since then the Government has lent a further Rs. 4 million of which three million rupees have been returned leaving a balance of Rs. 3 million owing to the Government. Apart from the Co-operative banking system itself, primary Societies are financed by the Government especially the C.A.P.S. Societies.

Concluding remarks on the Co-operative Movement

The discussion in the foregoing sections of this chapter leads to the conclusion that the co-operative movement has had only limited success in rural Ceylon. When considering each type of society it was seen that only a small proportion of small farmers are members of societies. The combined membership of primary agricultural societies at the end of 1955, was only 364,500.[33] Since some members may belong to more than one type of society, the actual number of small farmers who are members of co-operative agricultural production, sales and credit societies would be less than this figure. Even if this is ignored the total membership works out to less than 30 per cent of the estimated number of rural families in 1955.[34] The membership of the complementary type, namely, the rural retail society, was 520,166, i.e. less than 50 per cent of the total. Thus, approximately 50 per cent of rural families are not members of any type of co-operative society while about 70 per cent are not members of any type of agricultural society. This record is better than in some other countries; for instance, in India about a tenth, in Egypt about a fifth and in Turkey about a sixth only of the rural population are members of co-operatives.[35] Nevertheless, the Ceylon movement as yet excludes a large proportion of rural families.

There are several reasons why only a fraction of small farmers are members. Except at the very inception, the co-operative movement has been developed through the initiative of the Government. This is not peculiar to Ceylon. In India, Burma, Japan and most under-developed countries the movement has been fostered by the Government. It has, therefore, developed at the pace set by the Government. Until about 1942 the development was rather slow because the predominant type of society was the rural credit society and the Government did not show much keenness to increase the pace of its development. Since then, however, there has been rapid growth of Consumer Co-operatives at first and C.A.P.S. societies later. The Co-operative Department has been inadequately expanded to cope with an increasing volume of work[36]. Consequently, the field staff has not been able to organise more societies than they have done.

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33. The total membership of Rural Credit Societies, Marketing and Production Societies and Land Mortgage Banks.

34. See estimate of 1.3 million in Chapter II.

35. See, United Nations, *Rural Progress through Co-operatives*, p. 18.

36. See the complaints of inadequacy of staff repeated year after year in the departmental Administration Reports.

The inadequacy of staff alone would not have mattered had there been more spontaneous growth from below. But that has not happened except in a few areas, notably Sandalankawa. This may partly be due to ignorance on the part of the rural population. A more potent cause, however, is the fact that the people treat their society more as a Government Agency than a co-operative society. This is not necessarily due to ignorance of co-operative principles. It is mainly because the recent history of co-operation in Ceylon has been such as to create the impression that the co-operative movement is another kind of extension service offered by Government. Since there is little spontaneous growth, the pace of development of the movement has to depend on the rate at which Government staff is available.

The Co-operative movement in Ceylon is largely a Government creation. In the past, this has been both a cause of rapid development as well as a hindrance. It can safely be assumed that had the Government not stepped in there would have been fewer societies and fewer members. In order to help the expansion of the movement, Government helped it at a very early stage. However, the Government came into the movement in a big way only during the war. The abnormal circumstances in which the Government stepped in resulted in a very rapid expansion of the movement during the war. Societies were formed only for the very restricted purpose of distributing rationed consumer goods. Co-operative sub-Inspectors, hurriedly recruited and inadequately trained, went about the country addressing two, three or more public meetings per day and instructing people to form retail societies. Naturally, the officers had little time to supervise the activities of the societies. They continued to exist under the abnormal war conditions but immediately after the war many societies failed.[37] This has brought a certain amount of discredit on the movement. Both the Co-operative Department and the public have become rather cautious. Perhaps, the post-war experience was inevitable because the war emergency required rapid formation of societies which were bound to fail after the war. Nevertheless, it cannot be denied that it earned the co-operative movement a dubious reputation. The point is that

37. The number of retail societies fell from 4,004 in 1945 to 2,720 in 1955 despite the formation of new societies.

without Government intervention the movement would have developed less rapidly but at the same time the use of co-operatives during the war as a Government agency for distributing rationed goods and the subsequent failure of some of the societies has been a source of discouragement to the movement.

A further reason for the limited success, especially of the agricultural societies, is that they are not fully designed to suit the peculiarities of the rural sector. They do not cater for all the needs of the farmer. The C.A.P.S. societies lend for periods from six months to five years, for production and marketing purposes only. No long-term loans are given nor do they give short-term loans for consumption purposes, at least, not until the crop has ripened. The Rural Credit Societies lend for a maximum period of 18 months. They too appear to prefer productive purposes to consumption loans. Meanwhile, Co-operative Retail Societies do not sell goods on credit. Land Mortgage Banks are practically non-existent. Thus, the co-operative credit system, as a whole, still leaves the door wide open to the village moneylender and especially the village boutique-keeper.

This situation is not due to the lack of loanable funds. As was shown earlier, there is considerable excess lending capacity within the movement. There is scope for borrowing from the Local Loans and Development Fund of about Rs. 11 million. It is mainly because the co-operative societies have not been adequately designed to meet the needs of the rural sector fully. This again is due to the haphazard manner in which the movement has grown; there has been little deliberate planning in the past. Different types of societies have been created from time to time to meet different problems as they arose. There was little co-ordination of the activities to suit the needs of the customer. Thus, for instance, retail societies do not sell on credit because of the high risk involved. These risks could, however, be minimised if the farmer was required to market his produce through a co-operative marketing society so that the debts could be collected from the marketing society. Very recently a system of "link-up" co-ordinating the activities of the Rural Credit Societies, Retail Societies and C.A.P.S. Societies has been tried with success, especially in the Palugama area. Hitherto, each type of society worked in a water-tight compartment of its own and hence could not cater to the needs of the farmer. Future policy appears to be veering round to the multi-purpose type of society.

A further reason for the moderate success of the movement in the rural sector is the lack of leadership at village level. The educational system in the past had been geared to the production of administrative personnel. The few people in the villages who were able to get some education went into Government service as teachers, clerks, etc., and went out of the village into other villages or urban areas. There has, therefore, been a process of removing the better type of villager away from his own village. Those who stayed continued to cultivate their fields in the traditional manner. Co-operatives have had to draw largely on school teachers and village headmen for their committees. In consequence, on the one hand, the co-operative was further identified as a Government institution and, on the other, the transfer of a teacher or other officer led to dislocation within the society itself. This situation is likely to improve now that free education has been in force for about 12 years.

To sum up, there have been several factors which contributed to the limited success of the movement in the rural sector. Being a largely Government sponsored movement the pace of development has been set by the availability of Government staff for the purpose. Owing to inadequacy of staff there has been little supervision; this had led to a number of failures in the past resulting in discredit for the movement. Again, as a result of the unplanned development of the movement there has been no concerted effort to adapt the movement to the needs of the people. The lack of leadership at village level too has led to slower development.

CHAPTER VII

Sources of Credit—II

The enactment of the Co-operative Credit Societies Ordinance of 1911 was the culmination of a campaign conducted chiefly by the Ceylon Agricultural Society. Among the large number of articles and papers published between 1904 and 1910 on the subject of agricultural credit only a few had any doubts about the adequacy of co-operative credit. One such paper,[1] read before the Agricultural Society in 1906, deserves special mention. The paper surveyed the agricultural credit systems of a number of European countries and came to the conclusion that "state-aided land banks must precede, and their utility and success serve as an object lesson to the natives, before any popular banks either urban or rural can be started with any advantage to the public . . . it is hardly necessary to add that it will be impossible to develop the agricultural resources of Ceylon with such miniature societies alone". The models for land banks were the German Landschaften and the Credit Foncier de France. Although a few individuals were sceptical about the ability of co-operative credit societies, of the type recommended by the 1909 Committee, to meet the credit problems of the farmers there was no attempt in the early days to establish any other form of institution.

The failure of the 1918 monsoon in India and the consequent restriction of rice exports, on which Ceylon was heavily dependent, focussed attention on the problems of the small farmer once more. The food shortage became very acute and food rationing was introduced in 1919. The question of financing the small farmers, especially those engaged in food production, began to receive urgent consideration. Mr. K. Balasingham moved in the Legislative Council for the establishment of a bank to finance those engaged in the production of food. Consequently, in August 1919, a Committee was appointed "to consider and report on the desirability of establishing State Banks for the purpose of giving financial assistance to persons engaged in the production of food".

1. E.S.W. Senathi Rajah. "Agricultural Banks for Ceylon" a paper read before the Ceylon Agricultural Society in June 1906 and serialised in the *Tropical Agriculturist* of August, September and October, 1906.

The Committee on State Banks for Agriculturists, 1919

The terms of reference of the Committee were not as wide as those of the 1909 Committee. They were called upon to suggest remedies for an urgent problem, that of financing the producer of food.

They reviewed[2] the credit facilities then available for agriculturists and commented. "The banks operating in the Colony are essentially exchange banks, and require their funds to be as liquid as possible. They do not give any loans on mortgage, as that would necessitate the locking up of funds. Advances are made against produce in Colombo awaiting export . . . There is in the Colony no bank which provides advances against landed property". They also noted that the loans issued by Co-operative Societies were small short-term loans, rarely exceeding Rs. 100 and made the observation that—"Agricultural enterprise in the Colony is mainly financed by the moneylender and by private mortgages upon immovable property. The exchange banks have made a few isolated loans against large estates, but the business in private mortgages is extensive and common to all districts of the Colony . . . Rates of interest charged vary according to the amounts borrowed and the security offered. Evidence was given to the Committee that rates of 15 per cent, 20 per cent, or 25 per cent, were common for small loans . . . short date cash loans in small amounts without mortgage security are extremely common, and amount in the whole to a considerable sum. Loans in the shape of provisions from boutique-keepers are the general rule, and advances are also given against crops. Loans of paddy for seed and for maintenance during the cultivation season provide the common form of village credit, and are universal through the Colony". They recognised that difficulties due to complications of land titles would arise in any system of credit in Ceylon.

For the purpose of discussing credit needs the Committee divided agriculturists in Ceylon into three categories namely, the large estate owner, the small owner and the village cultivator. They thought that the large estate owner was rarely interested in food production and was in a position to secure private mortgages, but they needed better banking facilities. The small owner required

2. Report published as S.P. III of 1920, *State Banks for Agriculturists.*

credit for two purposes. Long term credit was required for the purpose of enabling him to tide over the years of development and for constructing residences and other buildings; short term credit for his maintenance or for the maintenance of his labourers during the time that crops were growing. They stressed the case of the small owner who " . . . deserves every encouragement, particularly as it is one of the surest means of aiding the economic development of the colony and of reducing the struggle for existence in the towns and cities already becoming noticeable . . . His requirements are easier means of securing credit, lower rates of interest, and terms which are equitable to the nature of the enterprise". They thought that the salvation of the village cultivator, who required small short term loans for current needs and, more rarely, long term loans for permanent improvements, was in Co-operative Credit Societies. The funds of the societies were inadequate but they should seek more deposits rather than depend on Government loans.

They recommended that loans to agriculturists should be made from state funds under a central supervising agency. The Local Loans and Development Commissioners who were administering the Local Loans and Development Fund were to constitute the central supervising agency. They opposed the establishment of a central state bank for the purpose on the grounds that it would be unwieldy and would require a large number of branches. They also opposed a centralised bank dealing in mortgages and thought that private banks with numerous branches should carry out the work of land banks. The state loans were to be distributed directly through the Government Agents[3] to cultivators at 9 per cent interest per annum. They, thus, did not recommend the establishment of any special agricultural bank and indeed opposed the idea of a state sponsored bank. They set out to suggest a scheme to assist food cultivators and appear to have been satisfied that it could be done with the existing administrative machinery. Although they reviewed the entire banking structure they made no specific recommendations for its improvement, apart from expressing the desirability of privately owned land banks and of increasing the available banking facilities.

3. The Government Agent is the chief representative in a Province or District of the Central Government Administration.

In the Government Estimates of Expenditure for 1920-21 a sum of Rs. 50,000 was provided for loans to Co-operative Societies, Agriculturists etc., under the votes of a new Food Production Department. Meanwhile, the situation in India had improved. With the resumption of normal food supplies the enthusiasm for food production appears to have abated. The problem of providing credit to small agriculturists receded into the background until in 1926 Mr. K Balasingham, once again, moved that Government funds should be utilised for financing agriculture. This motion led to the appointment, in November 1927, of a Committee "to frame a scheme for the establishment of a State Mortgage Bank for Ceylon".

The State Mortgage Bank Committee, 1927

The Committee[4] considered the scope and functions of a mortgage bank and were of the opinion that "mortgage banking lies altogether outside the field of operation of the ordinary banks in the East. Again it lies entirely apart from the branch of business which can safely be carried on by Primary Co-operative Societies in rural areas . . . mortgage banking based mainly upon the security of landed property should deal with long term loans required for permanent improvement of land and only repayable out of savings over a term of years". They carved out meticulously the sphere of activity of the proposed bank and excluded everything except the financing of the development of land for agricultural purposes. They drafted a detailed scheme with a number of safe-guards for maintaining the solvency of the bank. On the recommendation of the Committee, the Ceylon State Mortgage Bank Ordinance No. 16 of 1931 was passed; and the Bank itself opened its doors to the public on the 5th December, 1931.

The Ceylon State Mortgage Bank

The Bank's activities are controlled by a Board of Directors consisting of "five fit and proper persons" appointed by the Minister of Finance. Their actions are governed by Ordinance No. 16 of 1931. The Directors serve during the pleasure of the Minister; each appointment is for a period of five years and may be renewed. The Bank has its office in Colombo; although the Ordinance authorises the establishment of branches no branches have so far been opened.

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4. *Report of the State Mortgage Bank Committee*, S.P. XXI of 1929.

The Government has granted the Bank a number of special privileges, such as Government guarantee of Bank's debentures, the right to foreclose without recourse to a court of law, exemption of debentures from stamp duty, power to inspect the valuation roles of local authorities without payment of fees, and priority of claim on the properties mortgaged to the Bank. In return for these privileges the Government exercises strict control over the Bank's activities. The manner of raising funds as well as the issue of loans and a number of other aspects are regulated by statute. Every five years a special officer is appointed to investigate the policy, general management and affairs of the Bank. Further, every six months the accounts of the Bank are audited by the Auditor-General. The manner of keeping the accounts is also prescribed by law. The Bank is, therefore, essentially a state-sponsored and controlled lending institution.

The Bank has no capital and does not accept deposits. It raises the funds for lending by the issue of redeemable debentures which are guaranteed by Government in respect of both capital and interest. Consequently, the debentures are a gilt-edged security and are recognised as "trustee securities". Until recently the Bank's debentures were liable to stamp duty both at issue and at transfer, but by an amending Act passed in 1955 they have been exempted from stamp duty. In February and June 1956, the Bank raised two loans by the issue of debentures. The first was of Rs. 2.5 million at $2\frac{1}{2}$ per cent interest with maturity dates of 1961-1963; the second was of Rs. 1.75 million at 3 per cent with maturity dates of 1969-71. Throughout its existence, the Bank has found little difficulty in obtaining funds on its debentures.[5]

The debentures are taken up by a variety of investors as the table below shows. The bulk of the new issue has been alloted to commercial banks and insurance companies. Since its inception in 1931 up to the end of September 1955, the Bank had issued Rs. 33.9 million of debentures of which Rs. 19.3 million had been redeemed leaving a balance of Rs. 14.6 million. In addition to the issue of debentures the Bank also obtains temporary accommodation both from the Treasury and its bankers. The Bank has always been able to obtain the funds it required without any difficulty.

5. In more recent times the Bank has had some difficulty in obtaining funds due to heavy borrowing by Government in the local money market.

TABLE I

State Mortgage Bank—Debentures—Allotment of 1956 Issues

Class of Subscriber	*Amount (Rs. million)*	*% of Total*
Commercial Banks	1.58	37.2
Savings institutions	0.35	8.2
Sinking funds	0.04	0.9
Departmental and other official funds	0.27	6.4
Trust, Provident and Pension funds	0.61	14.3
Insurance companies	1.18	27.8
Other companies	—	—
Individuals, clubs and institutions	0.22	5.2
	4.25	100.0

Source:—Central Bank of Ceylon, *Annual Report*, 1956, p. 25.

Purpose of Loans

The authors of the Bank intended that it should lend only for strictly agricultural purposes. Since then the purposes for which it may lend have been expanded. At present the Bank is empowered to lend for the following purposes:—

(*a*) the purchase or lease of agricultural land; its development and improvement and capital expenditure necessary for the preparation of its produce for the market;

(*b*) the liquidation of any debts already incurred for any of the above purposes;

(*c*) the purchase or lease for a period of not less than 49 years of any building or the land appurtenant thereto or of any land suitable for building purposes;

(*d*) the erection of a building on any land;

(*e*) the discharge of a mortgage on any building or the land appurtenant thereto or any land suitable for building purposes; and

(*f*) the liquidation of any debts incurred for building purposes.

Under its enlarged scope, the Bank lends for both agricultural and housing purposes.

Tables II (*a*) and (*b*) show the purposes for which the Bank has lent money in the past. Until about 1950 the Bank was lending primarily for agricultural purposes. Since then housing has absorbed a large proportion of its loans. In the last two years, housing loans have become more important than agricultural loans. It would appear that the primary purpose for which the Bank was established has been forgotten, and that the Bank is now lending more for housing than for agricultural purposes.

TABLE II (*a*)

Purpose of Loans, 1932 to 1953

(*Rs.* '000)

Period—1st Oct.-30th Sept.		*Agriculture*	*Building*	*Mixed*	*Total*
1932-1935(*a*)	..	3511	60	—	3571
1936-1940(*b*)	..	5127	1623	460	7210
1941-1945(*c*)	..	1998	291	402	2691
1946-1949(*c*)	..	5863	1037	501	7401
1950-1953(*d*)	..	6225	5597	812	12634

Sources:—

(*a*) C.H. Collins—Report on the State Mortgage Bank, S.P. XXIV of 1936
(*b*) C.E. Jones—Report on the State Mortgage Bank, S.P. XXVII of 1941
(*c*) N.U. Jayawardene—Report on the State Mortgage Bank, S.P. VII of 1951
(*d*) W.J.A. Vanlangenberg—Report on the State Mortgage Bank, S.P. VIII of 1955

TABLE II (*b*)

Purpose of Loans, 1953-54 and 1954-55

Purpose	1953-54 *No.*	1953-54 *Amount (Rs.)*	1954-55 *No.*	1954-55 *Amount (Rs.)*
Agricultural				
Purchase	6	742,500	10	777,500
Development	9	192,000	4	12,000
Payments of old debts	2	180,000	10	228,000
Other and payment of debts ..	16	1,311,000	10	908,000
Total Agricultural loans	33	2,425,500	34	1,925,500
Building				
All building purposes	68	2,509,000	70	3,454,400
Total—All loans	101	4,934,500	104	5,379,900

Source:—Reports of the Board of Directors, 1954 and 1955.

Security for loans

The Bank grants loans only on the primary mortgage of immovable property in Ceylon. Further loans are granted on the same property only if the first mortgage is also held by the Bank. The property must be owned by the borrower or it should be a lease from the Crown which is not due to expire within thirty years from the date of grant of the loan. The Bank does not grant loans on the security of an undivided share of a property. Until 1956, when the law was amended the title to the property should have been valid in the eyes of the Bank's legal advisers who were the final authority for determining the validity of title. The Board of Directors had no discretion in the matter. The Board had to satisfy itself "that the title of the borrower to the land offered as security has been passed by the legal adviser as valid".[6] In practice the legal advisers have laid down very stringent conditions with the result that title is not accepted as valid unless it derives from a crown grant or partition decree or it is accompanied by an unbroken and undisturbed chain of title for 100 years. A very illuminating document regarding the standards applied by the Legal Adviser is annexed as Appendix A to this chapter.

Reference has already been made to the absence of registration of title to land in Ceylon. Under the circumstances a credit institution has to take reasonable precautions to ensure the validity of title. However, there is a deal of difference between taking reasonable precautions and eliminating risks altogether. There are other lenders, private moneylenders as well as the Agricultural and Industrial Credit Corporation, who apply less stringent conditions. The very exacting conditions applied by the Bank's legal advisers have, in effect, reduced the usefulness of the Bank, especially to small farmers, who find it extremely difficult and expensive to establish the degree of validity of title required by the Bank.

Table III shows the securities mortgaged to the Bank from its inception to the end of September 1955. The bulk of the properties are tea, rubber, coconut and undeveloped lands. The extent of

6. In 1956, this particular clause was deleted and the new clause substituted in its place requires the Directors to "be satisfied that the borrower has valid title to the property offered as security".

TABLE III

Security of loans, 1932 to 1955

Type of property	Extent of Number
Tea acres	38,019
Rubber acres	20,490
Coconut acres	28,482
Paddy acres	3,300
Other products acres	3,973
Undeveloped land acres	29,036
	123,300
House properties—Number	**753**

Source:—Report of Board of Directors for year ended 30.9.1955.

paddy land mortgaged is small in comparison suggesting that small farmers, the bulk of whom are paddy cultivators, get very few loans from the Bank.

The amount of loan

The minimum loan which the Bank may grant is Rs. 2000 while the total amount outstanding from any one person may not exceed Rs. 1,000,000. In view of the preliminary and administrative expenses involved it is considered uneconomic to lend sums below Rs. 2000. There are certain costs like valuation fees and costs of examining title and subsequent supervision and collection costs which do not vary in proportion to the size of the loan. The burden of fixed charges on small loans is proportionately higher than on larger loans. However, this fixed minimum for loans reduces the usefulness of the Bank to small farmers.

As shown in Chapter V, the average value of property per rural family in 1950-51 was Rs. 2765 of which land and buildings accounted for Rs. 2197. Until 1955 the Bank lent only 50 per cent of the value of the security; since then the proportion has been increased to 75 per cent. To be able to obtain even a minimum loan from the Bank, a small farmer should possess approximately Rs. 2750 worth of acceptable security. The average rural family did not possess that amount worth of immovable property in 1950-51; and the average individual farmer would necessarily have possessed much less. Since the Bank does not lend on the security of undivided shares, the minimum value of property required by a single farmer to obtain even the minimum loan would be about Rs. 2750. There is no data to ascertain the percentage of small farmers who possessed more than Rs. 2750 worth of property. Judging from the average value of family property, individual farmers who possess Rs. 2750 worth of immovable property must be extremely few. Only those few will be entitled to get even a minimum loan from the Bank.

However, the mere possession of the required amount of property would be inadequate; the title must be valid and the property has to be valued by two independent valuers who would normally apply more strict standards in valuing property than those adopted by the Investigators at the Rural Economic Survey of 1950-51. The standards adopted by the Bank's valuers are likely to rule out most rural buildings as worthless for the Board of Directors must be satisfied—"that the security offered is adequate, regard being had to the market value of the property, to the annual income derived or likely to be derived from it in the future, to the possibility of its depreciation in the future and the risks incidental to a forced sale". The market value of rural houses is small and the income almost nil as there is no demand for renting of houses in rural areas. The houses are mostly built of wattle and daub and are thatched. Their cost and hence their value is small. Most rural houses would not enter into the calculations of the Bank's valuers. The form of security with some market value which the small farmer can offer would be land; but, he has an insufficient extent of it to qualify even for the minimum loan offered by the Bank. Even where he has a sufficiency of land his title has to be accepted by the Bank; that appears to be as difficult as for the proverbial camel to pass through the eye of a needle. Thus the services offered by the Bank are hardly suited to the peculiar circumstances of the small farmer. He is seldom in a position to qualify even for a minimum loan of Rs. 2000.

In practice, the Bank has been lending even less than 50 per cent of the value of property taken as security. Between 1941 and 1949 the Bank lent only 43 per cent of the value of the securities given and in the period 1950 to 1953 it lent only 39 per cent of the value of the securities given.[7] These figures indicate that the actual

7. W.J.A. Vanlangenberg—*Report on the State Mortgage Bank*, S.P. VIII of 1955, p. 7.

lending policy of the Bank has been even more restrictive than is allowed by law.

The tables below show the size of loans actually granted. Between 1932 and 1955 only about a fifth of the loans granted were

TABLE IV (*a*)

Size of Loans 1932-1953

	Total No. of loans 1932-53
Rs. 2000 and below Rs. 5000	234
Rs.5000 and below Rs. 10,000	240
Rs. 10,000 and below Rs. 50,000	397
Rs. 50,000 and over	167
	1038

Source:—Calculated from the same sources as Table II(a).

TABLE IV (*b*)

Size of Loans—Agricultural only—1953-54 and 1954-55

	No.	*Amount* (*Rs.* '000)
Rs. 2,000 and below Rs. 5,000	11	29.0
Rs. 5,000 and below Rs. 10,000	8	56.5
Rs. 10,000 and below Rs. 50,000	25	525.5
Rs. 50,000 and over	23	3740.0
Total	67	4351.0

Source:—Calculated from Reports of Board of Directors 1954-1955.

less than Rs. 5000 each. In the last two years approximately a sixth of the number and less than one per cent of the amount of agricultural loans were in the below Rs. 5000 category. The bulk of the agricultural loans were given out in 23 loans of over Rs. 50,000 each. These figures serve to confirm that the Bank's loans are hardly availed of by small farmers.

Period of loan

The minimum period for which the Bank lends is for 5 years and the maximum is twenty-five years. It is essentially a long-term lender. In practice, however, the minimum period is no hindrance to obtaining shorter period loans because a borrower is entitled to repay at an earlier date provided he gives the Bank three months' notice; repayment is to be made in half-yearly instalments either by the method of reducing instalments or by the method of equated payments.[8]

Rate of Interest

The rate at which the Bank can lend depends on the rate at which it can borrow. It has been able to borrow cheap because its debentures bear a Government guarantee. Consequently its lending rates are lower than the rates charged by other lenders for similar loans.

The actual rates of interest[9] charged from borrowers vary according to the size of the loan and the type of security offered. The present rates are as follows:—

Size of Loan	*Rate of interest if secured by House Property within Municipal limits*	*Other classes of Property*
Rs. 2,000 and under Rs. 5,000 ..	5½%	6 %
Rs. 5,000 and under Rs. 10,000 ..	5 %	5½%
Rs. 10,000 and under Rs. 50,000 ..	4½%	5 %
Rs. 50,000 and over	4 %	4½%

There are two essential features in these rates of interest, namely, the rate of interest is highest on the smallest loans, and the rate of interest is lower by ½ per cent on each size category of loans if the security offered is a house property situated within Municipal limits. The reasons for charging a higher rate of interest on small loans, according to the third report[10] on the working of the Bank, are,

1. small loans involve work as much as, if not more than, large loans both in the preliminary stages upto the grant of the loan and subsequently during the currency of the loan, and

8. Vide Chapter I for an explanation of these two methods.

9. These rates have since been changed. There was a flat rate of interest from 1957 to 1961 after which the rates have been as follows:—

Size of loan (in Rs.)	*Rate of interest for developmental purposes*	*Rate of interest non-developmental purposes*
2,000—10,000	5½%	6½%
10,001—and over	6 %	7 %

10. N. U. Jayawardene—op. cit.

2. small loans are more troublesome to collect than large loans and probably carry a greater element of risk.

There is, in theory at least, a high degree of validity in these two arguments. However, the Bank also charges a commission of 2 per cent of the amount of the loan with a maximum of Rs. 320 for loans up to Rs. 200,000 and Rs. 520 for larger loans together with a fixed sum of Rs. 20 for office expenses. The fixed element in the charges also bears heavily on the small loans.

Although the theoretical plausibility of the second reason cannot be denied, in practice the Bank has never been seriously threatened with a disproportionate amount of overdues although it has granted both big and small loans. Up to 30th September, 1955, the Bank had granted 1230 loans totalling more than Rs. 43 million. The number of cases in which the Bank has had to foreclose was only five, i.e. less than ½ per cent of the total number of loans. Even if all such loans were small loans the proportion of default works out to only 5 out of over 225 small loans, which is quite a satisfactory record. The Bank under its present regulations takes very little risk in all types of business which it undertakes, both big and small. There is no evidence to show that smaller borrowers have defaulted more often than larger borrowers; and all of them appear to be defaulting most infrequently. The past experience of the Bank does not fully justify the policy of discrimination in interest rates in favour of large loans.

On the other hand, the rate of interest charged should not only consider costs and risks but should also bear some relationship to the ability of the borrower to bear it. The second criterion is especially important for a lending institution which is not merely a commercial concern but an instrument of development established and controlled by Government. The larger borrowers are more capable of paying a given rate of interest than the smaller ones. From the point of view of ability to pay, there is the possibility of charging higher rates on larger loans in order to compensate for the lower rates charged from small borrowers. What the Bank should aim at doing is to balance its overall budget by lending at an average rate which compensates it sufficiently for the total costs incurred in its business. It is hardly equitable for the Bank to charge high rates from all small borrowers as a class only because some small borrowers may be expected to default more often. In fact from the point of view of ability to pay the interest rates should be biased in favour and not against the small borrower.[11]

The Bank also charges a preferential rate of interest on loans secured by house properties in municipal areas. This preference is granted because

1. the risk of depreciation of the value of the security is lower, and
2. house properties in municipal areas are more readily saleable.

The post-war experience in Ceylon would tend to confirm the truth of this argument. Urban house properties have appreciated in value owing to the increase in population and the consequent housing shortage in urban areas. However, the Bank seems to be forgetting the main purpose for which it was established. Originally, the Bank was expected to finance only agricultural purposes. Subsequently, housing has been included as one of its lending purposes. This does not, however, mean that the Bank should actually compete with other institutions which already finance housing and discriminate against its own field of activity. The Loan Board, the Ceylon Savings Bank and the Housing Loans Department are all such institutions granting loans on the security of house property, particularly in municipal areas. It would be hardly necessary for yet another Government sponsored institution to cut into this market by actually offering a higher inducement by way of preferential rates of interest. On the other hand, the agricultural sector, which the Bank was primarily intended for, is penalised with a higher rate of interest. Whatever the cost and risk considerations involved are, it hardly appears to be the right policy for an institution established primarily to serve the agriculturists.

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11. There is a precedent in Ceylon for such a policy. The rates charged by the Ceylon Savings Bank are as follows:—

Size of loan		*Rate % per annum*
Rs. 2,000 and below Rs. 5,000	..	3.0
Rs. 5,000 and below Rs. 15,000	..	3.5
Rs. 15,000 and below Rs. 40,000	..	4.0
Rs. 40,000 and below Rs. 100,000	..	4.5
Rs. 100,000 and over	..	5.0

Further conditions attached to loans

The right to recall loans, the supervision of loans and the method of recovery in case of default will be discussed under this heading.

The Bank is forced to recall a loan if the Board of Directors is satisfied that—

(i) the land given as security has depreciated in value to such an extent as to endanger the safety of the loan; or

(ii) the title of the borrower is such that it ought not to have been accepted as adequate; or

(iii) owing to material misstatements by the borrower or misapprehension of the actual facts by the Board the loan was granted in circumstances in which it would not have been granted if the true facts had been known.

The Board has no option in the matter. If it is satisfied that any of these conditions are true, it has to recall the loan. The loan will then be considered to be in default unless the borrower offers adequate additional security.

The Banking Commission[12] commented that the first condition was unfair in that if the value of the property depreciates at any time it would be the very time at which the borrower is likely to be in difficulty. To recall a loan at that time would be hardly fair by the borrower, who may be able to arrange his affairs and make good the loan at a later date if he is left alone at the time of difficulty.

Further, if a sustained depression like that of the early 'thirties were to take place this provision would hardly be adequate to safeguard the interests of the Bank. During the depression the Bank had only started to function and did not carry any loans given before that. If, however, it had, it would have found this provision impracticable. When the Bank lends only 75 per cent of a conservatively valued security, this condition would apply only if the property depreciates below 75 per cent of its assessed value. In the case of any particular loan, which has been in currency for some time, the danger level would be reached only when the value falls even below 75 per cent, i.e. a drastic fall in value would be necessary. When property values decline so drastically, the Bank

12. op. cit., p. 148.

would find that the bulk of its securities have fallen in value. If at this time the Bank were to recall all such loans, it would find itself owning unsaleable properties. This would, indeed, defeat the very purpose of recalling the loans. It is fortunate that in its twenty five years of existence the Bank has not run into a drastic fall in the general level of property values. If it does, this particular provision, unless amended in time, would only lead to a failure of the Bank itself.

There is, of course, a value in this provision, namely that if only some properties depreciate in value or the borrower is wilfully ruining the property, the Bank can recall the loan. Such a contingency would be provided for if the Board could exercise some discretion in the matter instead of being compelled by law to recall a loan.

The Board of Directors has the right to investigate that the loan is being utilised for the purpose for which it was taken. The Board sends out Inspectors to check on the proper use of the loans. It can also call upon the borrower to adduce evidence before a Director that he is, in fact, utilising the loan for the purpose for which it was taken. Failure to satisfy the Board results in recall of the loan.

In case of default, the Bank has the right to foreclose without recourse to a Court of law. This is a privilege granted to it by Government. As stated earlier, the Bank has had only five occasions to resort to foreclosure as borrowers have so far defaulted only rarely. During the period 1950 to 1953, only two borrowers defaulted five times, three four times and six three times.[13] Eventually they pay up and are made to pay an additional penal rate of interest.

13. See report by W.J.A. Vanlangenberg, op. cit.

The demand for and supply of loans

Table V shows the number of applications and how they have been disposed of in recent years. The number of applications for loans has been increasing steadily during the years. This increasing

TABLE V

Demand for and supply of loans, 1950 to 1955

	1950 (*a*)	1951 (*a*)	1952 (*a*)	1953 (*a*)	1953-4 (*b*)	1954-5 (*b*)
No. of applications brought forward from previous year	48	39	32	92	98	131
No. of new applications during the year	89	72	150	199	238	270
TOTAL ..	137	111	182	291	336	401
Loans granted during the year ..	67	51	50	85	101	104
Applications withdrawn or rejected during the year	31	28	40	76	104	170
Applications carried forward to next year	39	32	92	130	131	127

(*a*) Calender years; (*b*) Financial years, 1st Oct. to 30th Sept.

Source:—Same as Tables II(*a*) and (*b*).

pressure of applications had led to an accumulation of arrears. Is it that the Bank, with its present staff, is incapable of handling the demand for loans? It appears to be so. The rejected or withdrawn cases have also shown a marked increase over the years. The Bank rejects applications unless they satisfy the rather stringent condition of validity of title, and valuation and suitability of purpose referred to earlier. Withdrawals, on the other hand, may be due to the availability of an alternative source of credit.

There also appears to be considerable delay in handling loan applications. During the period 1950 to 1953 the delays in handling loan applications were as follows:—

TABLE VI

Length of time taken to grant loans from date of application, 1950 to 1953

Time taken	*No. of cases*	*% of total*
3 months	72	29
6 months	97	38
9 months	44	17
12 months	23	9
Over 12 months	17	7
	253	100

Source:—W.J.A. Vanlangenberg, op. cit.

One third of all loans were granted only after a delay of over six months; seven per cent took over a year. Delays are normally caused by the procedure involved in verification of title and valuation. Perhaps, the present staff is also unable to handle all the applications for loans. However, past reports on the working of the Bank do not blame the staff for delays. It would appear that the major cause for delay is the complicated legal formalities of verifying title.

Whatever the reasons, Table V suggests that the number of loans granted annually by the Bank is insufficient to meet the existing demand for its loans. Meanwhile the Bank is lending more money for housing than for agriculture. When the Bank was allowed to finance housing in the 'thirties it was mainly because the volume of agricultural business was insufficient to run the Bank economically; and also at that time there were few housing loans available from elsewhere. The situation has changed completely since then. The Bank has more business than it can cope with. Meanwhile, there is a specialised institution set up to finance housing. In the circumstances it would be in keeping with the original purpose which the Bank was expected to serve if the Bank were to grant preferential consideration to agricultural loans.

The Agricultural and Industrial Credit Corporation (AICC)—Origin

Two members of the State Mortgage Bank Committee of 1927 added a rider to the Report.[14] This drew attention to the difficulties encountered by Ceylonese middle-class businessmen in obtaining credit. They did not think that the scope of the State Mortgage Bank should be expanded to cover such needs but, by implication, they stressed the need for some other institution. The Committee on State Banks for Agriculturists of 1919 had also drawn attention to the desirability of expanding the existing banking facilities. Subsequently in 1932, a resolution[15] was placed before the State Council that "A Commission should be appointed to go into the system of commerce, banking and insurance in the Island". The motion was referred to the Executive Committee for Labour, Industry and Commerce which accepted it in principle but narrowed

14. op. cit. Rider by H.M. Macan Markar and D.S. Senanayake.
15. Resolution by Mr. George E. de Silva in the State Council in November 1932.

the scope of the inquiry. Eventually, a commission was appointed in April, 1934, "to inquire into and report upon the existing conditions of banking and credit in Ceylon and to consider the steps, if any, that are feasible and desirable in respect of the provision of banking and credit facilities for—

(*a*) Agriculture
(*b*) Industry
(*c*) Trade

and also to make recommendations regarding the desirability of establishing a State-aided Bank and sound local Banks".

The Commission[16] surveyed the salient characteristics of the whole economy and discussed the credit needs of its different sectors. They devoted a chapter to problems of agricultural finance. Agriculturists were classified into three main categories on the basis of the part they play in the plan of production, namely, the landless cultivator, the landowning cultivator and the landlord agriculturist who does not work with his hands but enjoys the income from his land. The settlers in the new peasant colonies were included in the second category. The landless cultivator may be an agricultural labourer, share cropper or lessee. The labourer needed no credit for production purposes but if his employment was irregular he required credit for maintenance during unemployment. They thought that "no form of organised credit agency can help them". The land-owning cultivator was in need of short, long and medium term credit. The co-operative credit societies should be extended to cover more of his needs.

Regarding the landlord agriculturist they said "Most of these big estates are in the hands of non-Ceylonese and owned by joint-stock companies with non-Ceylonese capital. In view of their financial solvency, organisation and methods of accounting and auditing, as well as their intimate contact with foreign monetary centres and the existing banks, they do not seem to be experiencing any difficulty in the matter of credit". The indigenous estates were in need of both short and long-term credit.

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16. *Report of the Ceylon Banking Commission,* S.P. XXII of 1934.

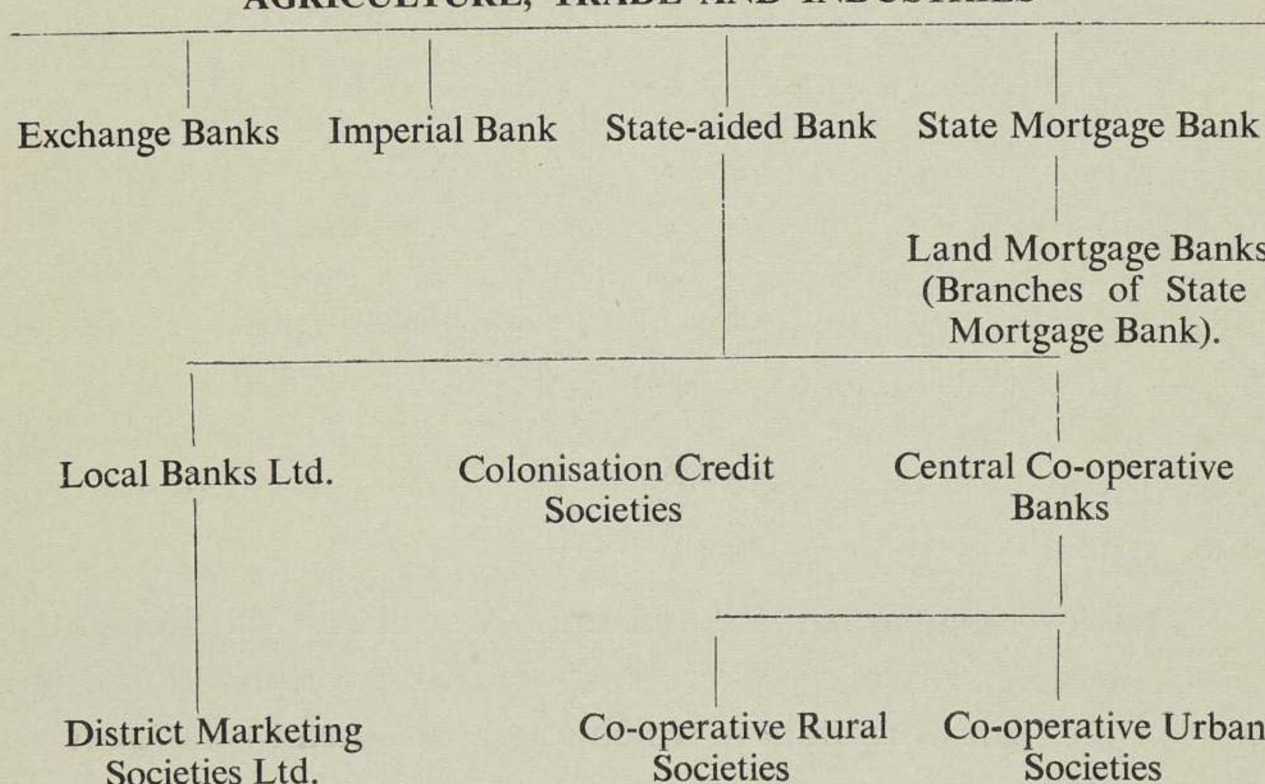
The commission recognised the existence of a number of obstacles in the way of agriculturists in obtaining credit, the chief among which were:—

(i) complication of title to land;
(ii) fragmentation of land;
(iii) absence of suitable subsidiary occupation;
(iv) absence of fixed tenancy; and
(v) existing indebtedness.

They also discussed the general defects in the law of mortgage and other laws applicable to the purveying of credit.

The recommendations of the commission were very broad based. They recommended a complete banking structure for Ceylon, the pivotal point of which was to be a State-aided Bank. The Chart below shows the banking structure proposed by the Commission—

PROPOSED BANKING STRUCTURE FOR CEYLON TO AID AGRICULTURE, TRADE AND INDUSTRIES



Source:—Reproduced from *Report of the Ceylon Banking Commission* facing p. 73.

Agricultural credit was to become the responsibility of the State-aided Bank and the State Mortgage Bank. The former was to combine both commercial and development banking; it was to finance agriculture through Local Banks, Colonisation Credit

Societies and the Co-operative credit system. The State Mortgage Bank was to function through branch Land Banks. The Colonisation Credit Society was a special type to meet the peculiar circumstances of colonists because they had no absolute title to the land they cultivated and were, therefore, similar in status to landless cultivators for credit purposes. After they had functioned for some time they were to be converted to co-operative credit societies.

In view of its implications affecting Government finances, the scheme was referred to the Secretary of State for the Colonies, together with the comments and suggestions of the Executive Committee for Labour, Industry and Commerce. The Executive Committee were in favour of establishing a State-aided Bank substantially on the lines recommended by the Banking Commission. The Secretary of State referred the scheme to an expert Committee consisting of persons with wide banking interests from the City of London. The expert Committee thought "that the proposals are not sound from the point of view of well-tried and accepted principles of banking".[17] The Secretary of State agreed with this view. That initiated a controversy with the Secretary of State for the Colonies and the Committee of experts on the one side and the Executive Committee of Labour, Industry and Commerce and the Chairman of the Banking Commission, Sir Sorabji Pochkhanwala, on the other. The principal bone of contention was the advisability of combining commercial banking and development banking functions in the proposed State-aided Bank. Eventually, after nearly five years of controversy, the commercial banking functions were separated and vested in the Bank of Ceylon which was established as a State-aided Commercial Bank in 1939.

The development banking functions, which were thus separated from commercial banking, were entrusted to the Agricultural and Industrial Credit Corporation, which was established by the Government in 1943.

Meanwhile, on the recommendation, again, of the Banking Commission and, once again, after a great deal of official controversy, a Debt Conciliation Bill had been passed in 1942. The

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17. The quotation and the information regarding the ensuing controversy are taken from Sessional Papers, Nos. I and XXVIII of 1937. *Correspondence regarding the establishment of a State-aided Bank.*

Ordinance provided for the readjustment of debts by mutual consent between debtors and creditors and for the re-financing of such debts. The re-financing of debts was included as part of the functions of the Agricultural and Industrial Credit Corporation.

The Corporation was set up with two objectives in view, namely,

(i) to finance agricultural development and to re-finance the debts of those agriculturists who could not obtain any relief from the then available sources of long-term credit; and

(ii) to aid industrial development.

It opened its doors to the public in December 1943.

The affairs of the Corporation are managed by a Board of eight Directors. Three of them represent the ex-officio members, the Ministers of Finance, Agriculture and Industry. The five others are nominated to serve for three years, or longer if re-appointed, by the Minister of Finance. The five nominated Directors serve during the pleasure of the Minister of Finance. The day-to-day administration is handled by a General Manager, assisted by a Secretary, an Accountant and other subordinate staff. The Board of Directors and the administrative staff act within the rights, duties and purposes prescribed by the Agricultural and Industrial Credit Corporation Ordinance, No. 19 of 1943 and its subsequent amendments. The Corporation has its office in Colombo; and, although the Ordinance authorises the establishment of branches outside Colombo, no branches have so far been established.

The Government has granted to the Corporation privileges similar to those granted to the State Mortgage Bank. In return, the Government exercises control over the activities of the Corporation. It is established and governed by statute. The Directors are appointed by the Minister of Finance. Government can investigate the affairs of the Corporation and, if necessary, wind it up. Thus, like the State Mortgage Bank, the Agricultural and Industrial Credit Corporation is a state controlled long term credit institution, the period for which it lends being the same as that of the State Mortgage Bank.

The Corporation has no capital and does not accept deposits. It can raise its funds by issuing debentures or by raising loans from Government. The debentures, like those of the State Mortgage Bank, carry a Government guarantee in respect of capital and interest. However, no debentures have been issued so far because the Corporation has been able to obtain all its funds from the Government Consolidated Fund. The limit for such advances was Rs. 3 million originally but it has been increased from time to time and stands now at Rs. 30 million. The aggregate amount outstanding to the Government from the Corporation at the end of September, 1955, was Rs. 29,350,000 on account of Principal and Rs. 769,992 on account of interest. The Government charges interest on the advances at rates agreed at time of lending; the rate has remained at 3½ per cent per annum from the very inception. This would probably be the rate at which the Corporation would be able to borrow on the market on its debentures. The last issues of the State Mortgage Banks' debentures were made at par and carried interest at 2½ to 3 per cent. Perhaps, a slightly higher rate of interest would be necessary if the Corporation were to place its entirely new debentures on the market. Nevertheless, it would enhance the independence of the Corporation, if it issues its own debentures, as the State Mortgage Bank does, instead of relying solely on Government advances.

Business of the Corporation

As the name suggests, the Corporation is concerned both with agriculture and industry. It is authorised to undertake not only the lending of money to agriculturists, industrialists and co-operatives; it can manage, supervise, or control the business of a borrower, act as technical adviser to a borrower, set up marketing organisations on behalf of a borrower, act as the agent of a borrower in the purchase of machinery, equipment etc. Further, it can acquire movable or immovable property, manage and control such properties or sell them. Generally speaking, the Corporation is entitled to take an active part in the affairs of its borrowers in order to ensure the safety of its loans. In practice, the Corporation does not have the technical competence to step into the shoes of an inefficient borrower; it would, normally, do so only in case of default. Nevertheless, it does keep an eye on the borrowers by means of periodic inspections of the properties by its Inspectors.

The primary concern of this study is with the lending policy of the Corporation. It is authorised to lend money for the following purposes:—

(*a*) the purchase or lease, or the cultivation, development or improvement of any land used or to be used for any purpose of agriculture or for the exploitation of the mineral resources thereof;

(*b*) the purchase or lease, or the construction repair or renewal of any building, factory, mill, mine, machinery or equipment used or to be used in connection with any agricultural or industrial undertaking;

(*c*) the manufacture or preparation of any agricultural or industrial product or commodity for sale in the market;

(*d*) any purpose incidental, accessory or ancillary to any purpose mentioned above; and

(*e*) the liquidation of any debt already incurred for any purposes mentioned above.

In addition, it can also lend money to any Co-operative Society for the purpose of conducting any agricultural or industrial business and to any person for the purpose of carrying out any scheme approved by the Minister of Finance for the development of agriculture or industry. In the field of agricultural credit the purposes for which the Corporation lends are almost identical with the purposes for which the State Mortgage Bank lends. The agricultural credit functions are common to both institutions; the one lends, additionally, for industrial purposes, the other for housing.

Tables VII (*a*) and (*b*) show the actual purposes for which the Corporation has been lending money. It is seen that, although the Corporation is entitled to lend both for agricultural and industrial purposes, 87% of the loans have been for agricultural purposes. Among agricultural purposes, the purchase of agricultural property accounts for the bulk of the loans. In fact, very little is borrowed for the development of agricultural property. One of the common criticisms levelled against the Corporation is that instead of lending for development it is lending for the re-financing of existing assets.

TABLE VII (*a*)

Purpose of Loans, 1943-1955

Period		*Agricultural*		*Industrial*		*Total*	
		No.	*Amount* (*Rs.*)	*No.*	*Amount* (*Rs.*)	*No.*	*Amount* (*Rs.*)
1943-49(*a*)	..	230	12,483,525	36	1,479,000	266	13,962,525
1949-50(*b*)	..	141	6,062,100	20	493,000	161	6,555,100
1950-51	..	146	8,598,983	19	856,150	165	9,455,133
1951-52	..	157	8,293,980	26	1,957,000	183	10,250,980
1952-53	..	152	6,702,144	34	2,170,131	186	8,872,275
1953-54	..	165	5,216,010	16	302,100	181	5,518,110
1954-55	..	152	5,351,139	20	574,850	172	5,925,989
Total	..	1,143	52,707,881	171	7,832,231	1314	60,540,112

(*a*) December 1943 to September 30, 1949.
(*b*) 1949-50 to 1954-55, financial years October 1st to September 30th.

Source:—Annual Report of the Agricultural and Industrial Credit Corporation, 1954-55.

TABLE VII (*b*)

Purpose of Agricultural Loans 1943 to 1955

Period		*Purchase of Agricultural Property*	*Redemption of debt*	*Development of Agricultural property*	*Total including mixed purposes*
			(*in Rs.* '000)		
1943-49	..	4222.7	1802.0	1373.9	12483.5
1949-50	..	4025.5	887.6	254.0	6062.1
1950-51	..	6103.5	1438.7	351.8	8599.0
1951-52	..	3975.5	2908.9	389.8	8294.0
1952-53	..	1638.5	4109.9	308.9	6702.1
1953-54	..	313.5	3776.4	287.4	5216.0
1954-55	..	746.0	3250.0	318.0	5351.1
		21025.2	18173.5	3283.8	52707.8

Source:—Same as above.

This is substantially true. Nevertheless, the Corporation is supplying an essential need for re-financing in the economy especially in the context of substantial foreign ownership of land. In the process, of course, it may have financed some speculative land purchases but the essential point is that the need for re-financing exists.

Security for loans

The Corporation is entitled to accept as security (*a*) a primary mortgage of immovable property in Ceylon; or (*b*) a primary mortgage of movable property in Ceylon; or (*c*) a mortgage of the crops or farming stock of any agricultural land in Ceylon.

A secondary mortgage is accepted provided the primary mortgage is also with the Corporation. Undivided properties are not accepted unless all the co-owners become parties to the application for a loan.

The title of the borrower to any immovable property offered as security must be valid. There is no definition of validity in the Ordinance and the Board of Directors can take a reasonable view, unlike in the case of the State Mortgage Bank. In practice, the policy of the Board has been to accept sound marketable title provided there is evidence of a documentary title without a defect for about 40 years. In some cases the Board also accepts a title "when it is satisfied on the available documentary evidence that there is a presumption of prescriptive possession which may not be questioned, in view of the fact that such possession has been both uninterrupted and undisturbed".[18] The policy of the Board in regard to title has been less stringent than that of the State Mortgage Bank.

Table VIII shows the securities mortgaged to the Corporation from its inception to the end of September, 1955. It is seen that

TABLE VIII

Security for loans, 1943-1955

Type of property	*Amount*
Tea—acres	48,691
Rubber—acres	36,635
Paddy—acres	2,683
Coconut—acres	24,492
Other products and undeveloped land—acres	39,189
Total—Land—acres	151,690
House property and building sites in urban areas—No.	191
Factories and Mills—No.	60

Source:—Annual Report AICC—1954-55.

18. *Annual Report of the Agricultural and Industrial Credit Corporation*, 1954-1955.

despite the fact that the AICC has existed for a decade less there has been a greater extent of agricultural land mortgaged to it than to the State Mortgage Bank. The total amount lent is also almost twice the amount lent by the CSMB. This would be due to the more flexible lending policy of the Corporation. Nevertheless, the extent of paddy lands mortgaged to it is also small; an indication that the small farmers make little use of it.

Although the corporation is entitled to lend on the security of crops it has so far not done so, presumably because there is no law regulating crop loans in Ceylon.

Amount of loan

The minimum loan which the Corporation may grant is Rs. 500; the maximum is governed only by its practice of giving only 75 per cent of the value of the secured property. The value of a security is determined having regard to its market value, earning capacity, the possibility of depreciation, the risks involved in a forced sale and other relevant facts.

The minimum limit of the loan is considerably less than that prescribed for the State Mortgage Bank. The fact that a similar institution following a more flexible and hence more risky lending policy has found it possible to lend sums as small as Rs. 500 also takes away the sting in the arguments used by the CSMB for keeping its minimum as high as Rs. 2000.[19] The minimum loan given by the Corporation places its services within the borrowing capacity of small farmers provided their titles are acceptable. In fact, in recent years the Corporation has gone out of its way to make its loans available to small borrowers. It has tried to subsidise their initial costs and those incurred by applicants in obtaining title deeds and other documents are reimbursed by the Corporation under certain circumstances, namely:—

(1) that all such documents are obtained from the Land Registry by the Corporations' lawyers;

(2) that a loan is actually granted;

(3) that the amount applied for does not exceed Rs. 5000 and

19. The discussion in this paragraph is related to the discussion of "the amount of Loan" in the section on the State Mortgage Bank.

(4) that all such documents will remain the property of the Corporation.

After the loan is fully repaid the documents may be given to the borrower on payment of the relevant costs incurred by the Corporation.

Table IX shows the size of loans granted in the last two years. A little more than a fourth of the number of loans granted and

TABLE IX

Size of Loans—1953-54 and 1954-55

	No.	*Amount* (*Rs.* '000)
Rs. 500 and below Rs. 5,000	91	230.2
Rs. 5,000 and below Rs. 10,000	69	439.9
Rs. 10,000 and below Rs. 50,000	130	2587.5
Rs. 50,000 and over	63	8186.5
	353	11444.1

Source:—Annual Reports AICC. 1953-54 and 1954-55.

nearly 2 per cent of the amount, were in the below Rs. 5000 category; this is a better record for small loans than that of the CSMB. Nevertheless, the bulk of the business is in comparatively large loans. The modal group, as with the CSMB is the Rs. 10,000 to Rs. 50,000 category, while the bulk of the money lent is absorbed by a few large loans of over Rs. 50,000. These figures afford further proof that small farmers make very little use of the Corporation.

Rate of Interest

The rate of interest chargeable from borrowers varies according to the size of the loan.[20] The present rates of interest are as follows:—

Amount of loan	*Rate of Interest*
Rs. 500 and under Rs. 5,000	6½%
Rs. 5,000 and under Rs. 10,000	6 %
Rs. 10,000 and under Rs. 50,000	5½%
Rs. 50,000 and over	5 %

20. These rates have since been changed. There was a flat rate of interest from 1957 to 1961 after which the rates have been 5½% per annum on developmental loans and 6½% on non-developmental loans.

On each category of loans, the rate of interest is ½ per cent more than that charged by the CSMB on agricultural loans. This difference is maintained in view of the greater flexibility of the Corporation's lending policy.

These rates of interest are also higher for small loans than for large loans. The unsuitability of such rates has been argued earlier. These arguments apply with somewhat less force in the case of the Corporation because of its less stringent lending policy and the fact that it reimburses the initial costs incurred by successful applicants for small loans. Nevertheless, as was argued in connection with the interest rates of the CSMB, cost of lending is not the only criterion that should be used in fixing interest rates. The ability of the borrower to bear given rates of interest is equally important. Further, the AICC, like the CSMB, is not simply a commercial concern trying to maximise its profits; it is a deliberate instrument of development established by the Government and should serve the Government's policy of helping the small farmer, who needs the services of such institutions most due to his inability to obtain finance elsewhere.

Further conditions attached to loans

The right to recall loans, the supervision of loans and the method of recovery in case of default will be discussed in this section.

There are no specific reasons prescribed by law for recalling loans. If the Board thinks that such a course is advisable, it may request a borrower to provide additional security or it may recall the loan. The Board is entitled to use its discretion and need not state any reasons for recalling a loan. In practice, the Board would take into consideration the manner in which the loan is being utilised, any changes in the market value of the secured property, any change in the ability of the borrower to repay and, in general, the expediency of an immediate recall as opposed to allowing the borrower to continue repaying in instalments. The important point is that, unlike in the case of the CSMB, the decision is left to the discretion of the Board of Directors.

The Board has the right to investigate whether a loan is being utilised for the purpose for which it was taken. It may call upon a borrower to adduce evidence that a loan is in fact being so used. It also has a staff of Inspectors who inspect secured properties from time to time.

In case of default, the Corporation can enter into possession of the property without an order of court. It really has two courses of action open to it. It can either enter into possession, appoint a manager, and manage the property until the total debt and any incidental costs are fully repaid, or it can directly proceed to sell the property by public auction, at which it can place an upset price below which the property can be sold only to the Corporation. These powers of the Corporation for recovery in case of default are very wide and cut out the cumbersome procedure referred to in Chapter V. It, like the CSMB, has had very infrequent recourse to foreclosure despite its less stringent policy.

The Corporation, like the CSMB, has also the advantage that, except in the case of a mortgage registered prior to the grant of its loan, it has a prior claim on the secured property. The proviso would normally be in-operative because the Corporation lends only on the security of a primary mortgage, a second mortgage being allowed only if the first is also held by the Corporation. Thus, unless a borrower contracts a loan and the mortgage is registered during the short period between verification of title by the Corporation and the grant of its loan, for all practical purposes, it has an absolute priority of claim over the mortgaged property.

The demand for and supply of loans

The table below shows the demand for the Corporation's loans and how it has been met in recent years. The number of applications which the Corporation has to handle annually has reached 619 in 1954-55; the highest number which it has disposed of, including withdrawals, in a single year was 194 in 1953-54. It appears that the Corporation is incapable of handling all the applications for loans. The arrears have increased considerably. The number of loans granted by the Corporation each year is clearly insufficient to meet the existing annual demand for loans.

TABLE X

The demand for and supply of loans, 1949-50 to 1954-55

	1949-1950	1950-1951	1951-1952	1952-1953	1953-1954	1954-1955
No. of applications brought forward from previous year	212	264	216	257	285	261
No. of applications for new and additional loans during the year ..	405	314	361	312	362	358
Total ..	617	578	577	569	547	619
Disposal—loans granted	161	165	183	186	181	172
rejected	15	8	6	7	13	5
withdrawn	177	189	131	91	92	88
carried forward.. ..	264	216	257	285	261	354

Source:—Annual Reports of the AICC, 1949-50 to 1954-55.

There is no evidence regarding the average delay in granting loans after receiving applications. In the last year the number of applications carried forward was almost equal to the number of fresh applications during the year, suggesting average delays of six months to a whole year or more. The usual reason for delay is the time involved in verification of title. Apart from that, the centralisation of all business in a single office in Colombo would also lead to delays.

Concluding remarks on the two long-term credit institutions

Before summing up, it would be relevant to consider the extent to which the combined loans granted by the CSMB and the AICC satisfy the demand for mortgage loans in Ceylon. Table XI shows the combined loans granted by the two institutions and the total registered mortgages in Ceylon. The total of registered mortgages is not equal to the total demand for mortgage loans because some mortgages are not registered and because there is likely to be some amount of unsatisfied demand for such loans. Thus, the actual proportion of the demand for mortgage loans met by the two institutions would be even less than that indicated by the table. The data do illustrate the fact that these two institutions on the average account for less than 10 per cent of the mortgages in Ceylon. They have made very little impression on the market for mortgage loans. There are a number of reasons why these two institutions have made little headway.

TABLE XI

Registered mortgages of immovables in Ceylon

Year		*Total amount registered (a)*	*Loans granted by CSMB (b)*	*Loans granted by AICC (b)*	*Total loans by CSMB and AICC (b)*
			(*Amounts in Rs.* '000)		
(1)		(2)	(3)	(4)	(5)
1933	..	23279	1188	—	1188
1934	..	18212	459	—	459
1935	..	25042	908	—	908
1936	..	22021	2510	—	2510
1937	..	26031	2411	—	2411
1938	..	28878	1134	—	1134
1939	..	26610	991	—	991
1940	..	24577	1096	—	1096
1941	..	25847	555	—	555
1942	..	30933	661	—	661
1943	..	32925	517	—	517
1944	..	42162	544	591	1135
1945	..	45121	166	3344	3510
1946	..	76828	592	2612	3204
1947	..	86473	1665	1775	3440
1948	..	66686	2282	2613	4895
1949	..	74223	2400	3028	5428
1950	..	85041	2570	6555	9125
1951	..	97453	2645	9455	12100
1952	..	115237	3184	10251	13435
1953	..	96377	4225	8872	13097
1954	..	140806	4935	5518	10453
1955	..	121732	5380	5926	11306

Note:—(*a*) Amount registered during year ended 31st December.
(*b*) Amounts granted during year ended 30th September.

Sources:—Annual Administration Reports of the Registrar General
Annual Reports of the CSMB
Annual Reports of the AICC

First, their policies regarding the acceptability of security have been restrictive. The AICC has applied less stringent standards for establishing validity of title than the CSMB, and has also made a special effort to attract the small borrower. Nevertheless, both institutions have been very cautious in determining validity of title. Consequently a number of borrowers who own property, but are unable to prove the validity of their title to it to the satisfaction of these two institutions, cannot obtain loans from them. The large number of applications for loans which are either rejected or withdrawn each year goes to show that these two institutions cannot, within their present policies, meet a large proportion of the demand for their loans. Their restrictive policy, necessary though it may be, is one of the most potent reasons why the institutions have made so little headway.

A second reason arises due to the location of these institutions. Both of them are located in Colombo and have no branches although they are legally entitled to open branches. There appear to be two reasons why branches have not been established, namely, that branches would mean higher administrative costs and that the volume of business may be insufficient for the establishment of branches. Indeed the establishment of branches would lead immediately to higher administration costs but that would not matter if it leads to a sufficient additional volume of business to cover the additional costs, i.e. if the marginal costs of the operation are equal to or lower than the marginal returns. Since these institutions are now lending only about 10 per cent of all mortgage loans annually and since some part of the balance 90 per cent is likely to be deterred from coming to them due to their location in Colombo, it is very likely that the establishment of branches, if it is done judiciously, will lead to an increase in the volume of business.

Further the past experience of both institutions also lends support to the view that such a venture is likely to be profitable. An examination of the accounts of both institutions in recent years shows that they have while expanding their volume of business earned increasing profits. This fact indicates that they are as yet operating under conditions of increasing returns and that there is, therefore, scope for expansion in the volume of business. Also the district by district distribution of the loans granted each year shows that the volume of business in some districts, especially Kandy and Kurunegala is sufficiently high to justify the establishment of branches. For instance, Kandy and Kurunegala districts took up Rs. 2.6 million out of Rs. 5.9 million lent by the AICC in 1954-55, this combined amount of loans in the two districts is almost equal to the total amount of loans granted by the AICC in 1947-48, a year in which it made a profit of Rs. 95,303 after meeting operating expenses of Rs. 54,572. The present costs of the same volume of business may be somewhat higher due to the increase in salaries and other prices: At the same time, the establishment of a branch does not require the same costs of administration because certain overhead costs like the services of the manager and the higher staff will be spread. The level of qualifications and responsibility required of a branch manager and the supervising staff would be lower and hence the salaries payable to them would be lower than in the case of the head office staff. Consequently, the same volume of business which the AICC handled in 1947-48 at a profit could be handled now by a branch also at a profit. Moreover, the volume of business is likely to expand owing to the location of a branch closer to a potential market. There is the additional point that, as will be discussed later, once the existing competition between the AICC and the CSMB is done away with, there are likely to be certain areas in which the combined volume of business of the two institutions is likely to be sufficient for the establishment of branches even if no new business is immediately forthcoming. The point of the whole operation would of course, be to tap new business.

There are also likely to be certain economies in establishing branches. As already stated, it would not require the same quality of administrative staff at branch level as at the head office. Again the cost of supervising the loans through a branch system would also be lower than where all supervision is handled by a central office. From the point of view of the borrower there is likely to be a distinct economy. At present a borrower has to establish contact with a central office situated in Colombo. If he has to appear at the head office even once, as he must do to sign the necessary documents, he has to incur travelling and other expenses. Such costs will be a substantial burden when the loan is small, as small as Rs. 500, for instance. A single trip to Colombo and back for a borrower may cost up to Rs. 25 which works out at 5 per cent of the loan. If a local office was available his costs would fall substantially. With a reduction in his costs he would be in a position to bear a somewhat higher rate of interest should the lending institution need to resort to this. The point is that the establishment of branches in certain districts is likely to lead to higher profits for the lending institutions and would also result in making its services available to a wider clientele. In the past, the lack of branches has prevented a number of potential borrowers going to the AICC and the CSMB.

At the same time the institutions have had to apply very strict standards regarding the validity of title because, operating as they do from such a distance, they are unable to judge the credit-worthiness of their borrowers. They have no local knowledge and, consequently, rely on the security of last resort, namely, the validity of title to the security. It is a security of last resort because the first line of defence which a lender has is the credit worthiness of the borrower. It is only if the borrower fails to repay and insists on defaulting persistently that realisation of a security becomes necessary. It is only then that absolute validity of title becomes necessary. Until then the real safeguard is the ability and inclination of the borrower to repay, i.e. his credit-worthiness. At present neither the CSMB nor the AICC is in a position to judge the credit-worthiness of a borrower. Consequently, they require to play absolutely safe on the question of validity of title. Once branches are established, it will be possible, with local knowledge, to investigate the credit-worthiness of borrowers; simultaneously it would be possible to relax the title requirements gradually. Such a step is likely to bring within the scope of these institutions a much higher volume of business than they have been able to handle in the past.

There has been a suggestion that the State Mortgage Bank should function through Co-operative Land Mortgage Banks.[21] This has, in effect, been turned down because the Bank would agree to lend only half the value of mortgages held by the Land Mortgage Banks, which in turn lend only 50 per cent of the value of the security to their clients. Consequently, they could have borrowed from the CSMB only about half the money required for their business. This has been unsatisfactory. Consequently, the arrangements have not worked. There are a number of advantages to be gained if the CSMB and the AICC lend through a network of Land Mortgage Banks. First, the central institutions will not be called upon to meet the additional administrative costs of a branch organisation. Secondly, the Land Mortgage Banks may themselves be able to obtain a part of the administrative services on a voluntary basis. Thirdly, the arrangement enables the local banks to gain personal knowledge of the credit-worthiness of borrowers, an important

21. Vide *Administration Report on the Working of Co-operative Societies* 1945-48,

factor which the central institutions have neglected in the past. This may in turn make it possible to relax the title requirements especially in case of small loans. Fourthly, it will enable the Land Mortgage Banks to obtain adequate funds for lending. Finally, and most important of all, the services of the CSMB and the AICC will be made available to small farmers at the village level.

At present there is considerable duplication of functions as between the two institutions themselves on the one hand, and between them and similar institutions on the other. The problem of overlapping functions was referred to in the third *report on the Ceylon State Mortgage Bank*.[22] The CSMB lends for agricultural and housing purposes. The AICC lends for agricultural and industrial purposes. The two of them compete with each other for agricultural loans. Meanwhile, the CSMB competes with the Housing Loans Department, the Ceylon Savings Bank, the Loan Board and Insurance Companies for housing loans. It is true that all these institutions together do not supply the total demand for housing loans but that is due mainly to unacceptability of title and other reasons which are not relevant here. In the narrow range of acceptable business the CSMB and the AICC compete with each other and the CSMB competes with the other institutions lending for housing purposes. Originally, the CSMB made losses on agricultural loans and was allowed to lend for housing. Then there were few housing loans available from elsewhere. Conditions have changed since. The CSMB and AICC together cannot cope with the demand for mortgage loans. Meanwhile there are specialised housing loans institutions. There now appears to be no reason for the CSMB to continue granting housing loans except to compensate for the competition of the AICC in the field of agricultural loans. Both these are Government controlled institutions and should not compete with each other. The AICC is not allowed by law to accept applications for loans which should normally be granted by the CSMB and the former also charges a slightly higher rate of interest. Nevertheless, the terms of the AICC are more favourable. Consequently, it commands a higher volume of agricultural business than the CSMB despite its shorter existence. Since such competition is unnecessary and wasteful, the reasonable thing to do is to eliminate it either by amalgamation or by a re-defining of functions.

22. N.U. Jayawardene, op. cit.

In the past the idea of re-defining functions has been suggested.[23] It was then recommended that the AICC, as presently constituted, should be replaced by an institution empowered to undertake promotional functions for new ventures in industry, commerce and agriculture requiring medium and long-term credit. Since this proposal was made, however, a new institution with such functions, the Ceylon Development Finance Corporation, has been established. The point of that proposal has, therefore, been lost. Under the present circumstances it would be possible to convert the CSMB into an agricultural bank and the AICC into an industrial bank. Immediately, however, such a division of functions may not be possible because the industrial business is small. Eventually there will be scope in the economy for two such banks with their branches. Until then, the feasible solution is to amalgamate them and utilise their combined administrative costs to spread out into branches or to supervise Land Mortgage Banks, as the case may be. The present costs and effort dissipated in competing with each other can then be used to extend the frontiers of a single central long-term credit institution catering both to agriculture and industry. Housing can be left to the Housing Loans Department. Such an institution functioning through a network of branches and Land Mortgage Banks would place its services within reach of the small farmers, who have hitherto had little access to the CSMB and the AICC.

APPENDIX—A

An extract from a printed letter which the Manager of the Ceylon State Mortgage Bank sends to all applicants for loans.

" 5. Investigation of Title—Documents required

The Bank accepts only title which is recommended by its Legal Advisers. If the title cannot be established in terms of the requirements of our Legal Advisers, no loan may be granted by the Bank. Our Legal Advisers require the title to be based on:

(*a*) Crown grants conveying absolute title, or

(*b*) Valid partition decrees of Court, or

(*c*) Deeds and documents in support of title covering a period of about 100 years.

23. N.U. Jayawardene, op. cit.

In any event the subsequent chain of title must be good.

The documents that must be submitted by the applicants for examination by the Legal Advisers are as follows:—

(*a*) All deeds and documents relating to the security offered.

(*b*) An abstract of title and pedigree.

(*c*) Certified extracts of encumbrances.

These must be complete and all extracts must be supplied dating back to the registration of the earlier deed in the chain of title.

(*d*) Partition Decrees and Certificates of title are accepted provided there has been conformity with the provisions of the Partition Ordinance. Therefore, copies of the following documents certified by the Secretary of the District Court must be supplied:— plaint, journal entries, total proceedings, preliminary decree, commission, return to commission, Plan of Partition, Final Decree or Certificate of title.

(*e*) Deeds, Originals should be tendered; where this is not possible copies thereof certified by the Registrar of Lands should be supplied. Copies of Deeds certified by Notaries are not accepted unless the Notary certifying the copy is himself the Notary who attested the Deed.

(*f*) Fiscal's Sale or Sales by the Secretary of the District Court in pursuance of a Mortgage—where this occurs in the chain of title copies of the following documents certified by the Secretary of the District Court must be supplied:—

(1) Decree

(2) Order confirming sale

(3) Order authorising the Fiscal to execute the conveyance.

(*g*) **Death** (1) Where there has been a Will copies of the following documents certified by the Secretary of the District Court should be supplied:—

(i) Last Will,

(ii) Probate,

(iii) Inventory and

(iv) Affidavit,

(2) Where there has been an intestacy copies of the following documents should be supplied:—

(i) Letters of Administration,

(ii) Inventory and

(iii) Affidavit.

(3) Where property is sold by an Administrator certified copies of the relevant court proceedings should be supplied.

(*h*) **Companies.** Where property has been dealt with by Companies certified copies of the Memorandum and Article of Association and copies of the relevant resolutions authorising Sale or Purchase (as the case may be) should be supplied. Where a Company is an applicant the resolution to borrow money from the Bank should be in terms of the draft resolution submitted to the Bank.

(*i*) **Minors, Lunatics, Insolvents.** Certified copies of all relevant documents and Court Orders should be supplied.

(*j*) **Sale by Liquidators.** Here two copies of all relevant documents and Court Orders should be supplied.

(*k*) **Sales under the Entailment and Settlement Ordinance.** Certified copies of the petition and all documents filed therewith together with a Certified copy of the order of court should be supplied together with copies of all journal entries thereto.

(*l*) **Plans.** All plans referred to in the chain of title should be supplied. Where originals are not available copies certified by a Licensed Surveyor should be supplied. In this connection where relevant endorsements have been made or subsequent Plans it may be possible to dispense with the production of earlier plans.

(*m*) **Certificates issued under the provisions of the Land Registration Ordinance.** Where second class certificates have been issued, certified copy of the proceedings held by the Commissioner should be supplied.

(*n*) **Deed signed by an Attorney.** The power of Attorney or a copy thereof duly certified must be submitted.

(*o*) Where property is situated within limits of a Municipal or Urban Council

(i) Assessment notice for the current year,

(ii) Tax Receipt for the Old quarter,

(iii) Non-vesting Certificate, and

(iv) Certificate of Registration of ownership from the Municipal or Urban Council must be supplied.

6. It would be advisable for you to show this letter and your title deeds to your Proctor and obtain his advice as to whether you will be in a position to establish your title according to the requirements of the Bank's Legal Advisers and if so obtain his assistance to complete the documents accordingly. On hearing from you that you have been advised by your Proctor that title acceptable to the Bank's Legal Advisers can be furnished by you, I shall forward to you a set of application forms and a leaflet of rules, the former to be returned to me duly filled up by you together with Bank Deposit for initial Bank Charges and deeds and documents as enumerated above and a detailed list of documents."

CHAPTER VIII

Sources of Credit—III

This chapter will be devoted to discussing sources of credit other than those discussed in the two preceding chapters. The other sources are:—

(*a*) Commercial Banks,

(*b*) Insurance Companies and semi-Government bodies,

(*c*) Pawnbrokers, and

(*d*) Moneylenders.

Commercial Banks

Commercial banks do not lend money to the class of farmer we have in mind. Banks functioning in Ceylon, other than three banks registered in Ceylon, are branches of foreign banks. The foreign banks were originally set up to finance the export trade of the foreign-owned plantation crops. They have continued to rely mainly on the discounting of foreign trade bills. The small farmer has no access to these banks. Of the local banks, the Hatton Bank is a small bank with no branches, functioning in the heart of the tea-growing areas primarily for the purpose of facilitating the movement of cash from Colombo to the estates to meet their cash requirements, especially for cooly pay. This bank too does not deal with small farmers. The role of another local Bank, the Co-operative Federal Bank, has already been discussed.

The biggest local bank, indeed the biggest of all banks in Ceylon, is the Bank of Ceylon. The circumstances leading to its establishment were outlined in the previous chapter. Under its proposed constitution, the Bank was expected to play a major role in the agricultural credit system; it was to have been an apex bank financing agriculture through the co-operative credit system and local banks. The proposed constitution was substantially modified and the Bank of Ceylon was established as a state-aided commercial bank in 1939. Under its modified constitution, the Bank of Ceylon exists primarily for financing the Ceylonese businessmen. Nevertheless, it lends money to credit agencies functioning in the agricultural credit field. The Co-operative Provincial Banks of Jaffna, Kandy and Galle and the Ceylon State Mortgage Bank have overdraft facilities with the Bank of Ceylon. The Co-operative Provincial Banks were in debt to all sources, other than the Co-operative Federal Bank, to the extent of Rs. 1.5 million at the end of 1955; only a part of this would have been due to the Bank of Ceylon. The Ceylon State Mortgage Bank overdraft at the end of September, 1955, was Rs. 1.8 million. Moneylenders too may be borrowing even a small part of their funds from the Bank. No information is available about the amounts outstanding to the Bank from moneylenders; nevertheless, the total amounts advanced by the Bank of Ceylon to agricultural credit agencies is comparatively small.

The Commercial banks in Ceylon are not an important source of credit to the small farmer. None of them are a primary source; the amounts of secondary loans is also small. This is but to be expected. The banks function in the larger towns. Only the Bank of Ceylon has branches in some of the smaller towns. Their location is unsuited for the small farmer. Moreover, they are modelled on traditional lines and lend only for short-term commercial purposes to their clients. It is not everybody who can open an account with the banks; initial deposits ranging from Rs. 250 to Rs. 10,000 or more are required for opening a current account. The cheque is an altogether unknown instrument of exchange in the Ceylon village. Further the banks do not lend for the purposes for which small farmers need credit; consequently, commercial banks in Ceylon are of little use to the small farmer.

Insurance Companies and Semi-Government Bodies

The Insurance Companies, the Loan Board and the Ceylon Savings Bank have funds seeking investment within Ceylon. They engage in mortgage financing but they lend only on the security of urban properties. Consequently, credit from them too is not available to small farmers.

Pawnbrokers

There is not much information available about the business of pawnbrokers. Their activities are regulated by the Pawnbrokers

Ordinance No. 13 of 1942. They lend for any purpose provided the pawn is acceptable to them. They accept mainly gold and silver jewellery. According to the rural indebtedness data for 1950-51,[1] 5.8 per cent of the total debt, amounting to about Rs. 5.5 million for the whole rural sector, was secured by pawns. In the same year, 1951, the business conducted by registered pawnbrokers is shown in Table I. This data referred to 966 pawnbroking and

TABLE I

Pawnbroking by Nature of Pledge, 1951

Nature of Pledge	*Advances Made*		*Outstanding at end of year*	
	No.	*Amount* (*Rs.* '000)	*No.*	*Amount* (*Rs.* '000)
Gold and Silver Jewellery ..	1,091,553	46492.6	352457	20,837.3
Furniture and other movables ..	3,401	645.4	2450	361.5
Others	114	35.1	28	15.9
	1,095,068	47173.1	354935	21,214.7

Source:—Department of Census and Statistics, *Census of financial institution*, 1952.

moneylending firms. The bulk of the business is in pawns of gold and silver jewellery. What proportion of the business was with small farmers is not known. The rural indebtedness data suggest that approximately a fourth of pawnbroking business is done in rural areas.

Apparently, the loans are taken for short periods; less than fifty per cent of loans granted during the year were outstanding at the end of the year. The law allows a period of twelve months and seven days after which the pledge has to be redeemed. After the lapse of this period, if the pawn is not redeemed, the pawnbroker becomes absolute owner of the pawn if the amount lent was equal to or less than five Rupees. If the amount was higher he has to realise the value of the goods by public auction, at which he is entitled to bid. After the sale the pawnbroker is required to allow inspection of the sale entry to the pawner and to pay to him, on

1. Vide Table VII, Chapter III.

demand, any sum realised in excess of principal, interest and auction expenses, provided such inspection is asked for within two years of the date of sale.

The rate of interest which a pawnbroker can charge is regulated by law; he is entitled to charge 12 per cent per annum for loans below Rs. 20 and 9.6 per cent per annum for loans of Rs. 20 and over. However, pawnbrokers are known to charge higher rates of interest. In 1951, the rates charged by pawnbrokers from their Government servant clients varied between 24 per cent and 48 per cent per annum.[2] It was then observed that "As no receipts are granted for the full payments made no proof of the excessive interest charged by a pawnbroker in violation of the law is available to the borrower, and it is therefore not possible to bring the offenders to task".[3] This refers to Government servants who are better placed to bargain with pawnbrokers than small farmers; in their case, the position can only be expected to be worse.

In 1934, at the time the Banking Commission[4] was reporting, there were five complaints made against pawnbrokers, namely:

1. A smaller sum is advanced than that shown on the pawn ticket;
2. An unauthorised deduction is made so as to get higher interest than what is permissible under the law;
3. Bogus auctions are arranged and the pledges are purchased by the pawnbroker directly or indirectly through nominees for much less than their real value;
4. the authorised rates of interest are high; and
5. there are many unlicensed pawnbrokers.

The Commission thought that the law gives the pawner sufficient protection against the first three mal-practices but the pawner's co-operation is necessary for the effective working of the law; that the rates of interest were not high; and that the last complaint could be removed by promulgation of the Ordinance in all areas. They also thought "the removal of the evils of the present system of pawnbroking does not lie in further legislation but in

2. *Report of the Committee of Indebtedness.* S.P. XVII of 1951, p. 8.
3. Ibid. p. 8.
4. *Report of the Ceylon Banking Commission*, S.P. XXII of 1934, p. 47.

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the introduction of public spirited and honest agencies".[5] A similar recommendation was made by the Committee on Indebtedness in 1951.

It is not possible to say anything about the extent to which the mal-practices complained of in 1934 exist at present. That, by one method or another, pawnbrokers charge higher rates than those authorised is highly probable especially in view of the fact that Government servants are known to have paid as much interest as 48 per cent for such loans. The *Census of Financial Institutions* showed that pawnbrokers advanced Rs. 47.2 million in 1951 and earned interest amounting to Rs. 4.9 million. This data, by itself, does not enable us to calculate the rate of interest. If there was no change in the amount outstanding at the end of the year, the average rate of interest appears to have been over 10 per cent. The data are suggestive only; it cannot be definitely stated that they actually charged higher rates than those authorised, although it is highly probable that they did so.

Why is it possible for pawnbrokers to charge illegal rates of interest? There can be a number of reasons. The majority of pawnbrokers are non-Ceylonese Chettiar firms. In 1951, there were 282 Ceylonese firms as against 684 non-Ceylonese firms.[6] The rates at which the Chettiar firms lend are regulated by the Nattukottai Chettiars' Association. The Chetty firms do not lend below certain rates fixed by the Association; they co-operate with one another. The Ceylonese firms do not have an organisation to regulate their rates of interest; their supply of loanable funds too is not as reliable as that of the Chettiars, who have access to funds from abroad. Consequently there is, in the matter of fixing rates, one large organisation accounting for nearly 60 per cent of pawnbroking advances and a large number of small firms which together account for only 40 per cent of such advances.[7] The unorganized and small Ceylonese firms would find it profitable to accept the minimum rates fixed by Chettiars for their business as well because they neither have the resources nor the organisation to compete with the Nattukottai Chettiars' Association, which has even international affiliations spreading over India, Malaya, Burma and other South Asian territories.

5. op. cit. p. 48.
6. Department of Census and Statistics, *Census of financial institution*, 1952.
7. Ibid.

Further, as far as small farmers are concerned, the pawnbrokers operate among semi-literate, if not completely illiterate, borrowers. Most of them would be ignorant of the existence of any law controlling the activities of pawnbrokers. In such circumstances they would be in a position to charge high rates of interest.

Pawnbroking is one field in which the institutional credit system has failed to provide an effective alternative source of credit. The Government-sponsored credit institutions, the co-operative credit system and the commercial banks, except the Bank of Ceylon in a small way, have not entered the field of pawnbroking. This is indeed a yawning gap in the credit system of a country in which part of the accumulated capital is known to be held in the form of jewellery for traditional reasons. There are no data on the amount of jewellery owned by rural families; but it is believed to be substantial. However, the important point is that, in a context in which suitable security is hard to come by, jewellery is a highly acceptable form of pledge. Yet it is a type of security which the institutional credit system has made no effort to utilise.

Moneylenders

For the purpose of discussion, moneylenders may be divided into two classes, namely non-professional moneylenders and professional moneylenders. The landlords, boutique-keepers, produce buyers, and friends and relatives will be included under non-professional moneylenders. The Chettiars, Afghans and Ceylonese moneylenders will be included under professional moneylenders. The information available about the activities of moneylenders is very scanty, more so in the case of the non-professional ones, for, after all, secrecy is one of the chief advantages in their type of trade. Hence the comments made in this section are based on personal knowledge substantiated wherever possible with published evidence.

The Landlord, in his role of moneylender, is in a peculiar position. The tenant is already under obligation to him as he is only a tenant at will with no legal rights of his own. When the tenant gets into the debt of the landlord his obligation increases. The landlord is in a position of influence over his tenant. He can dictate his terms to the tenant because the latter has few alternative sources of credit and because the landlord can, in the existing conditions of under-employment, always find a different tenant. However, in these credit transactions the landlord does not have to use his influence. The terms have been accepted for so long that they have become traditional. The usual rate at which seed paddy is given is at half bushel per bushel per season. At sowing time the landlord gives the tenant a bushel of seed paddy which is returnable after the harvest with an additional half-bushel. On the basis of a six month cultivating season, the rate of interest works out at 100 per cent per annum. The same terms apply even if one tenant borrows seed paddy from another or one landlord borrows it from another. These rates are rooted in tradition; they have been accepted by generations of cultivators. These traditions die hard for several reasons. Except in those areas where co-operatives exist and lend money for such purposes the farmer has no alternative source of credit. If he goes to any other village lender too he would have to pay as high, if not higher, rates of interest. Also, a farmer may want a particular variety of seed paddy which a particular landlord or other farmer possesses and would part with only on the traditional terms. The farmer's ignorance too would be a contributory factor. However, the key to the situation is the lack of alternative sources of credit. Given an adequate supply of credit for the purpose the traditional barriers are bound to breakdown eventually.

The normal method of long-term lending in the village is the usufructuary mortgage or *ukas*, as it is called in the villages. The borrower mortgages the use of his land to the landlord or other lender. The latter normally allows the borrower to continue cultivating the land on the traditional *ande* system, i.e. the borrower becomes a tenant on his own land turning over a share of the gross yield, usually half, to the lender, in lieu of interest. The usual transaction is somewhat as follows:—

One acre of paddy (say) is mortgaged to the landlord or other lender for Rs. 500 (say).

Yield per acre (approximately) 35 bushels at Rs. 12—Rs. 420. $\frac{1}{2}$ gross yield = Rs. 210 or over 40 per cent interest. Where there is double cropping the rate would be higher. On the other hand, if the yield is as low as 20 bushels and there is only one crop per year, the rate of interest is 24 per cent.

In fairness to the lender, it must be said that such a loan is more in the nature of a share purchase than a loan. The lender undertakes the risk of earning no interest at all if the crop were to fail. In that way the lender shares the business risks of his borrower; he enters into a kind of partnership with his borrower. However, although the lender shares the risks of the borrower he does not share his expenses. In that sense, it is like any other loan. Whatever the exact nature of the transaction, the return on it to the lender, unless there is a sustained period of crop failure, is high.

The usufructuary mortgage is suited to the peculiarities of the business of farming. Yields are very uncertain. The farmer finds it inconvenient to tie himself down to regular interest payments. The usufructuary mortgage enables the farmer to pay interest in proportion to his gross yield. When he has no crop, he pays no interest; when he has a bumper crop he can afford to pay a high rate of interest. The rate of interest varies in direct proportion to the ability of the borrower to pay as between one season and another. However, it has its disadvantages in so far as the repayment of principal is concerned. A small farmer who mortgages his plot of land has little else beside the land. When, by this transaction, about half of his gross yield and much more of his net income is utilised in the payment of interest, he is left with only a meagre income. He has little chance of repaying the loan and often, in the course of time, the effective ownership held by the lender is converted into legal ownership by paying the borrower an additional sum of money. Meanwhile, the lender would have made a substantial profit on the share of the gross yield he received in lieu of interest. The system, as it now operates, is unfair to the borrower because it takes too much as interest out of him and leaves him little with which to redeem the debt.

Despite the disadvantages of the usufructuary mortgage it has survived the test of time and is quite popular in the rural areas even now. It has survived because the rate of interest under the system compares favourably with rates of interest charged by Chettiars and other moneylenders in rural areas. It has the added advantage that the rate of interest varies directly in proportion to gross yield. The institutional credit system has offered no equivalent to this popular type of loan. It insists on good security, does not accept interest payments in kind and has fixed rates of interest. This is yet another instance in which those lending institutions have not been adapted to the peculiar circumstances of the people. It is not suggested that credit institutions should lend on usufructuary mortgages although there is no reason why they should not. The essential point is that the rate of interest is not fixed under the usufructuary mortgage and interest is acceptable in kind. It looks after both uncertainty of yield and uncertainty of price. The lender shares the risks of the borrower arising both from yield and price uncertainties. Whereas, the lending institutions in Ceylon do not share the business risks of the farmer except in the remote case where the farmer fails completely and they lose their principal. The terms of their loans are, therefore, less attractive than those of the usufructuary mortgage.

The boutique-keeper, is again in a peculiar position of advantage. His business is not credit, except where he himself undertakes long-term lending. His main business is trading. He fixes the prices of his goods having regard to their costs, the risks he takes in selling on credit and maintaining a sufficient margin of profit for his own upkeep. He is, himself, a very small operator with a capital of a few thousand Rupees. The average monthly income of rural families dependent principally on trade, in 1950-51, was only Rs. 112.75 per month.[8] Usually there are one or two boutiques in a village. Their individual turnover in a small village of poor families must be small. The village retail boutique can hardly be called an economic unit. The boutique-keeper, therefore, keeps a high margin of profit on his small turnover in order to make a sufficient income to live on. He cannot insist on cash payments for his goods because his customers can pay only at harvest time. He gives them their goods on credit. The farmers keep no accounts. The more unscrupulous boutique-keepers are said to inflate the sales and defraud the farmer. That may be so. Even without doing so the boutique-keeper can get a very high rate of return on his capital because he charges high prices.

A question which naturally arises is why others do not enter into competition with him. It is not possible to attribute this to a single cause but there are a number of reasons. First, although his rate of return on capital may be high, his aggregate income,

8. *Final report of the economic survey of rural Ceylon*, 1950-51, S.P. XI of 1914.

judging by the average income of Rs. 112.75 per month in 1950-51, is quite small and, therefore, unattractive to a new-comer. Secondly, the business of the village boutique-keeper is a highly specialised one. He must be able to assess the credit-worthiness and credit limits of each of his customers. He needs a sound knowledge of the financial affairs of his customers. Nor can he insist on his customer supplying such information; he, by long experience of dealing with a limited number of customers, has come to possess sufficient knowledge of their affairs to make certain shrewd estimates of the maximum credit he can extend to each customer. Any new-comer should not only be able to stand the competition of the already established boutique-keeper but also should possess first-hand knowledge of his prospective customers. Only another local person can be expected to possess such knowledge. Presuming that he has the finances to compete with the established boutique-keeper, there is every reason why, seeing that the boutique-keeper gets more income than themselves, some small farmers should sell up their lands and take to retail trading. Here, we come up against a third reason why the boutique-keeper does not have to face competition. The reason is social. It is to be found in the occupational immobility of the villager. He loves his land and would not part with it except as a last resort. Moreover, it is a noticeable fact especially in the Kandyan areas, that the boutique-keeper is a low-country Sinhalese, a Jaffna Tamil or a Moorman. They have settled down in the villages generations ago and have become part of it. The point is that the local villagers, because of reasons of occupational immobility, seldom take to the business of retail trading.

This again raises the question why such migrants do not come in now to compete with the established boutique-keeper. Here again, the reasons are that to be able to handle this kind of trade the newcomer has to build up a fund of local knowledge and should be able to compete with an already established trader in a market which owing to the low incomes of the customers, can support either the one or the other and not both of them. Competition, like the division of labour, is limited by the size of the market. Moreover, most of his prospective customers would, at any given instant of time, be at various degrees of obligation to the existing boutique-keeper. To oust him completely would be a formidable task even to a local person; it would be virtually impossible for an outsider. Indeed such outsiders have migrated into the new centres of population in the colonization areas and are known to be carrying on profitable business. There they have the advantage of being first in the field, which really is the key to success in this type of trade.

To sum up, for a number of reasons, both economic and social, the village boutique-keeper operates without competition from others in his own restricted area of operation. He is, however, not an absolute monopolist in the extreme sense of the word. He is a very small operator. He cannot charge any price he likes because at least those of his customers who have ready cash at some time would go to another boutique-keeper in an adjoining village or town. There are limits to his monopolistic powers.

During the abnormal conditions prevailing during the war, the Co-operative Retail Societies were able to cut into the sphere of influence of the boutique-keeper by virtue of the monopoly privileges they had of distributing the rationed goods. This initiative wrested during the war has been lost to some extent since the war because the Co-operatives do not allow credit facilities to their customers. As stated earlier, there are certain reasons why they do not sell on credit but it is easy to see that they cannot offer effective competition to the village boutique-keeper unless they compete with him in the trade-cum-credit business which he does.

There is another class of trade-cum-financier operating in the rural areas, namely, the produce buyer. Sometimes the boutique-keeper is the buyer of produce as well. In that case, he is in a position to obtain an even higher rate of return than he does through his consumer goods trade. The produce buyer, at the village level, is himself a small operator who supplies his merchandise to produce merchants in towns.[9] As with the village boutique-keeper, there are certain factors which tend to favour the small scale operator. First, the total quantity of the produce that can be bought in a village, which by reason of its poverty has little surplus for sale, is small. Moreover, this small quantity is not available in one place, it has to be collected by a house to house visit. Such small scale operation

9. It is a common sight in the villages of Ceylon to see a produce buyer carrying a sack on his back. They walk from house to house buying a pound of arecanuts here, a few coconuts there and other products like cocoa, coffee, paddy, etc. The somewhat better off buyer may own a hand cart to carry his load.

is obviously unsuited to large scale produce merchants. Hence, the produce merchants are content to sit back in the towns and collect their produce from a host of small operators working at the village level. Nor would it be a solution for a large scale operator to employ all the small operators as his buying agents because that would involve him in additional costs of supervision and of maintaining a regular staff even during slack periods. Further, unless he is supervised, an employee has less incentive to strike the best bargain than the self-employed produce buyer. Consequently, the present system is advantageous from the point of view of the larger produce merchants in the towns. Instead of dealing with a large number of small producers they can deal with a smaller number of small middlemen. The system is economical because the business of produce buying at the village level is suited more to small scale than to large scale operation. That is the explanation of the prevalence of the small scale produce buyer in the villages of Ceylon.[10] However, it is still necessary to explain why the village produce buyer is able to exploit the small farmer, as he is supposed to do.

There are a number of reasons why he can drive a hard bargain with the small farmer. First, he is dealing with a semi-literate farmer who has a lesser appreciation of the market than he has. Secondly, his transaction also involves the granting of credit. Sometimes, he buys for ready cash an already harvested crop. Often he pays an advance on a standing crop on the basis of a pre-arranged contract price for the entire crop. In this case, on the one hand, he needs some capital, however small, to be able to advance money to the farmer. On the other, he must have sufficient personal knowledge of the farmers to be able to trust them with his money and to keep to the unwritten agreement. His trade, like that of the boutique-keeper, is specialised in that he needs to have personal knowledge of the customers. Further, since some capital is required only those few with capital can engage in it. All commercial activity in the villages, like the business of farming itself, suffers from a dearth of capital. There is also the general occupational immobility, already discussed in connection with the activities of the boutique-keeper. As a result of these several factors the produce buyer is able to enjoy monopolistic advantages over a wide range of his

10. Indeed for similar reasons, the small produce buyer operates at local level among cocoa farmers in the Gold Coast and Nigeria.

transactions but he is not an absolute monopolist. He does not operate in a completely water-tight market. Farmers may carry their produce to a weekly fair or to another produce buyer operating in a nearby area. He has to safeguard himself against such competition. It is where he advances money to the farmer on an agreement to buy the entire crop that a shrewd middleman can make a higher profit. In this case, of course, he takes a much bigger risk.

The CAPS Societies were set up by Government, as stated earlier, partly with a view to weaning the farmers away from these middlemen. Since the Society is formed among local inhabitants and is managed by them, it has the advantage of local knowledge. It also has no dearth of capital since the Government is willing to finance it. Consequently, where the Societies have been established they have had a fair amount of success, especially because they are prepared to advance money on standing crops. However, there is as yet an insufficient number of CAPS Societies.

The amateur moneylenders are generally friends and relatives. They seldom lend money by choice. Their clients come to them in distress. They lend because they want to help a friend or relative in distress. Some of them may not charge any interest at all. Others would lend under terms which are accepted as reasonable in village areas. The usufructuary mortgage and amateur pawnbroking fall into the category of accepted types of loans. The terms of the usufructuary mortgage have already been explained. The pawn is only a safeguard in case of irrecoverable default; and usually it would be redeemed. Nothing is known about the rates of interest charged; but they are likely to be lower than those charged by other moneylenders, because the profit-motive is not the guiding factor in those transactions.

The Chettiar was an important source of agricultural credit prior to the depression of the 'thirties'. In fact, he was the main supplier of credit to the Ceylonese agriculturist. In their evidence before the Banking Commission, they stated that "With the exception of a few Ceylonese who had facilities for obtaining credit from the local banks, the bulk of the Ceylonese had to resort to the Chettiar moneylender in order to be financed in their undertakings".[11]

11. *Report of the Ceylon Banking Commission*, S.P. XXII of 1934, p. 41.

During the depression the Chettiar moneylenders, who were borrowing part of their funds from the Banks short and lending long, found it difficult to meet their obligations to the Banks. This resulted in drying up almost entirely that source of funds to the Chettiar. In consequence there has been a diminution of the volume of their business. Before the depression they were estimated to have owned Rs. 150 million worth of assets in Ceylon. In 1934, the total assets were about Rs. 100 million of which Rs. 45 million was given out on mortgages and other advances except pawns.[12] At the end of 1951, their outstanding mortgages and advances was only Rs. 22.9 million.[13] Their business appears to have declined substantially. It is not possible to say what proportion of the advances were given to small farmers. However, since the other mortgage credit institutions are hardly accessible to the rural sector, practically the whole of the rural debt secured by mortgages and promissory notes would have been owing to moneylenders. At the survey of 1950-51, the mortgages and advances on promissory notes accounted for 49.9 per cent of the rural debt or approximately Rs. 47.2 million.[14] It is not possible to say anything about how this amount was distributed among different types of moneylenders. However, since the total debt on mortgages and promissory notes owing to Chettiars at the end of 1951 was only Rs. 22.9 million, of which a part would have been lent to traders and big land-owners, the share of Chettiar moneylenders in the rural debt does not appear to have been very large. Nevertheless the Chettiar is still a comparatively important source of credit in the rural sector.

The Table below shows the business conducted by all registered moneylenders in 1951.

TABLE II

Money lending, volume of business 1951

	Ceylonese Moneylenders	*Non-Ceylonese Moneylenders*	*Total*
	Rs. '000	*Rs.* '000	*Rs.* '000
Advances made in 1951	5,727.6	37,399.0	43,126.6
Advances outstanding at end of 1951	2,477.5	22,980.4	25,457.9
Interest earned in 1951	564.5	4,143.7	4,708.2

Source:—Same as Table I.

12. op. cit. p. 42.
13. *Census of financial institution*, 1952.
14. See Table VII, Chapter III.

The non-Ceylonese moneylenders were those who belonged to the Nattukottai Chettiars' Association and were all Chettiar moneylenders. It is seen that the bulk of the moneylending business conducted by registered moneylenders is in the hands of the Chettiars. Since the Chettiar, as argued earlier, does not appear to be having as big a hold on the rural credit market, presumably a substantial proportion of moneylending in rural areas is done by unregistered and, in that sense, non-professional moneylenders. As stated earlier, the lending rates of Chettiars are determined by the Nattukottai Chettiars' Association.

The *Afhgans*, as the name suggests, are natives of Afhganistan. They have made moneylending their vocation, so much so, that the moneylending law in Ceylon presumes that an Afhgan is a moneylender unless the contrary is proved. The Afhgans generally operate in the larger towns, their chief clients are Government servants and those who frequent the racing tracks. Unlike the Chettiar, the Afhgan has not got himself integrated into the social life of the local population. He has hardly penetrated into the villages and, consequently, it is doubtful whether he lends any money in the villages at all. The Afhgan is known to be very harsh and merciless in his dealings with the borrowers.

The business of *Ceylonese professional moneylenders*, in 1951, is shown in the table below:

TABLE III

Ceylonese Moneylenders—business done in 1951

(*Rs.* '000)

	Advances made	*Outstanding at end of year*
Pawnbroking	17,201.1	6888.3
Moneylending	5,727.6	2477.5
	22,928.7	9365.8

Source:—Same as Table I.

The bulk of their business is in pawnbroking, which has already been dealt with. Their moneylending business is small in comparison to the Chettiars'.

The business of moneylending is regulated by the Moneylending Ordinance, No. 2 of 1918. The law prescribes the following rates of interest:—

On loans up to Rs. 100—20 per cent per annum.

On loans over Rs. 100 and up to Rs. 2,500—18 per cent per annum.

On loans over Rs. 2,500—15 per cent per annum.

However, only registered moneylenders are inhibited by the law and even they have adopted various methods to circumvent the law.

Their methods have been described as follows:—

"A Promissory Note is generally obtained for a sum equivalent to 150 per cent of the amount actually lent carrying interest at 18 per cent per annum . . . . The amount of the loan is to be liquidated in ten monthly instalments, each instalment being equal to 15 per cent of the actual loan. Payment commences one month after the date of the loan. Generally no receipts are granted for these monthly payments but the debtor is in some cases allowed to record such payments on the note. Among certain Chettiars, however, no endorsements are allowed in regard to the first one or two instalments".[15] The effective rate of interest is 120 per cent. In some cases, it is even higher. The rates charged by professional moneylenders from Government servants in 1951 varied from 120 to 300 per cent.[16] They probably charge even higher rates from the small farmers. The professional moneylender circumvents the law either by inflating the amounts of the loan or by deducting interest before granting a loan. In either case the effective rate of interest is higher than what appears on paper. Such mal-practices are committed obviously with the connivance of the borrower and hence the law is helpless. The borrower connives with the lender because his need for credit is so urgent and because he has no alternative source of credit available to him. His ignorance may also contribute in some measure to his conduct but the more important cause is that the institutional credit system has been incapable of supplying the needs of the small borrower. Because the farmer cannot obtain all the credit he wants

15. *Report of the Committee of Indebtedness. S.P. XVII of* 1951, p. 8.
16. Ibid.

from the cheaper sources of supply he has to go to the moneylenders who, therefore, as a class operate under conditions of imperfect competition.

The moneylenders as a class have been successful in retaining over 65 per cent of the rural credit market mainly because they have certain advantages in their business. Their success is essentially due to their very flexible lending policies. The greatest asset in their business is personal knowledge of their customers. Each operates in a small area among known borrowers. They can, therefore, afford to take far more risks than impersonal credit institutions. Consequently they do not insist on a high degree of validity of title,[17] because the security is not their first line of defence. They rely more on the credit-worthiness of their customers. As Table IV shows the bulk of their business is in promissory notes. The mortgages accounted for less than a fifth of their total advances in 1951.

TABLE IV

Moneylending—Nature of Security, 1951

	Advances made in 1951		*Outstanding, end of* 1951	
	No.	*Amount* (*Rs.* '000)	*No.*	*Amount* (*Rs.* '000)
Mortgages	5775	8485.5	3823	5840.7
Promissory Notes	26073	26940.7	13845	13863.5
Other Advances	1683	8168.1	1017	6040.0
	33531	43594.3	18685	25744.2

Source:—Same as Table I.

About 80 per cent of their business is based purely on personal knowledge of their customers, the only security is the I.O.U. of the borrower. It is possible to do this because the moneylender's transaction is a personal transaction as opposed to the impersonal transaction of the lending institutions.

The question naturally arises as to whether the moneylender is not taking a very big risk. He certainly does; but the essential point is that the risk he takes is less than the risk which the AICC

17. *Report of the Ceylon Banking Commission*, p. 45, S.P. XXII of 1934.

or the CSMB would take if they were to lend money on similar terms. The moneylender's risks are minimised by the fact that he lends to a special clientele whose every activity is known to him. He does not need to secure himself so thoroughly against default because he is in a position to keep an eye on his client's activities and to collect his dues personally from them. This personal relationship between lender and borrower accounts for the very high risks which the moneylender is able to take.

A further advantage which a professional moneylender alone has over credit institutions and non-professionals is the fact that, moneylending being his chief occupation, he is not unduly concerned with capital repayments. No doubt, he must be assured that his capital will not be lost but, once he is reasonably certain about the safety of his capital, it is to his advantage to delay repayment as long as possible. For, if one credit-worthy borrower returns capital he is confronted with the need to find yet another credit-worthy customer with whom to invest his money. Thus as long as unforeseen circumstances do not endanger the safety of his capital, the professional moneylender is content to allow his borrowers to pay only his interest charges. From the point of view of the borrower this is very advantageous. If, for instance, Rs. 1,000 is borrowed from a credit institution and it is repayable in 10 instalments, with 10 per cent interest the monthly instalment would work out to between Rs. 108 and Rs. 101. Whereas, if the same amount was borrowed from a moneylender at 10%, the borrower would have to pay immediately only the interest of Rs. 8.33 per month. The capital repayment can be postponed until he is in a position to pay it. Where incomes are unstable opportunities to repay also arise at certain times. Of course, in the former case, the borrower pays back a smaller total sum, but what matters, where incomes are very low and unstable is the periodical service charge rather than the total repayment. The borrower with small means can borrow from the professional moneylender on this kind of "never-never" plan. To such a borrower the immediate prospect of low service charges appeals more than the prospect of redeeming his debt.

There are also further reasons why moneylenders have advantages over credit institutions. The latter, before they grant a loan, insist on knowing the purpose for which the loan is required and other particulars about the transaction. The moneylender is not concerned about the demoralising effects of easy credit on his customers. As long as his client does not become bankrupt, he does not mind why his client borrows. This enables the borrower to obtain credit for purposes like weddings, funerals and other forms of conspicuous consumption from moneylenders whereas credit institutions, especially Government-sponsored ones, frown upon such borrowing. Moreover, since the transaction is between one man and another, there is a greater degree of privacy in borrowing from moneylenders. This privacy is important in the villages because in the Ceylon village there is a stigma attached to indebtedness. If a person wants a loan from the AICC or CSMB there would be valuers, surveyors and inspectors visiting his lands. The rest of the village would come to know that a loan is being taken. Whereas if one went to a moneylender with the title deeds the whole transaction would be done in the privacy of the lender's home and more expeditiously too.

From the point of view of costs too, the moneylender has certain advantages over the credit institutions. The moneylending firms, whether they be Chettiar firms, other professional firms or amateurs, are essentially small concerns in which only a few persons are employed. Of the 966 moneylending and pawnbroking institutions investigated in 1951, 611 were individual proprietorships and 355 were partnerships. The average Chettiar moneylending firm in Ceylon, for instance, is run by the head of the family with the aid of a *kanakapulle*, an accounts clerk. Generally the professional moneylender is a self-employed man who is capitalist, business manager, accountant and field supervisor, all in one. His costs, apart from the cost of his funds, consists of the expenses of himself and his family, which he would have incurred in any case, together with the direct costs involved in supervising the payments from his clients and some little office expenditure. Since his business is based on personal knowledge of his customers, his area of operation is small and, hence, his costs of operation are comparatively low.

There is no information about the sources from which moneylenders obtain their capital. In 1934, the capital of the Chettiars was made up as follows:—[18]

Personal capital	..	Rs. 85 million
Borrowed from relations in India	..	Rs. 14 million
Borrowed from local banks	..	Rs. 1 million
Total	..	Rs. 100 million

18. *Report of the Ceylon Banking Commission*, p. 42. S.P. XXI of 1934.

The experience during the depression showed the Chettiars the dangers of borrowing short from the Banks and lending long. The banks too were reluctant to continue financing the Chettiars, consequently this source of credit dwindled considerably. Even in 1934, the Chettiars were lending mainly their own money. Unfortunately, nothing is known about the sources from which Ceylonese moneylenders obtain their capital. However, since there are no credit institutions in Ceylon which lend money for sufficiently long periods for the purpose of moneylending, it may be presumed that, like the Chettiars, other moneylenders in Ceylon too lend mostly their own accumulated savings. Indeed this is an added reason why the professional moneylender is not unduly concerned about capital repayment because there is no outside pressure on him for repayment of loan capital. What matters is his opportunity cost. With little or no effort on his part he can get about 2 per cent to 3 per cent by depositing his money in a savings bank or by lending it to the Government, i.e. investing in gilt-edged. Obviously the moneylender is prepared to take greater risks than investing in gilt-edged securities and he is also prepared to make a greater effort in order to obtain a higher return on his money. He can also get, with little effort, but, somewhat lower risk a return of about 10 per cent if he buys tea or rubber shares.[19]

Under the circumstances, what would be the minimum return which he expects on his money in return for the high business risks which he takes and the effort which he is willing to devote to the business of moneylending? To an extent it would depend on what others charge for similar risk-bearing. The AICC and CSMB lend long-term at rates ranging up to 6½ per cent. The Co-operative credit system lends at rates varying from 4 per cent to 12 per cent per annum. The moneylenders, when they lend long, take for greater risks than the AICC or the CSMB as they are presently constituted, though the moneylenders' administrative costs are likely to be somewhat lower.[20] Similarly, that part of the short-term loans which reach him would include those that are likely to be rejected by the

19. According to a calculation made in respect of the year 1954, the return on Rupee Company Shares was as follows:— Tea—11.1%, Rubber—6.7%, Tea cum Rubber —9.3%, Coconut—14.8%, Commercial—8.8%.

20. It would, still be true that were the AICC or the CSMB, as presently constituted, to engage in the type of business presently handled by moneylenders the risks will be higher than those of moneylenders.

Co-operative Credit System. Thus, the moneylender would require a rate higher than what the AICC and CSMB charge for less risky loans, he would also have to be induced away from tea and rubber shares. The minimum rate at which he would be prepared to part with his money would vary from year to year but is unlikely to be under about 10 per cent; of course, the maximum rate which he expects will depend on what his market can bear. Where he has a monopolistic position he would charge very high rates on individual loans depending on the elasticity of demand for the loan. Nevertheless, the main point is that the minimum rate which a moneylender is likely to expect would be around 10 per cent per annum. The actual rate he charges would contain a further amount for the high risks, and any monopoly rate which he can extract from the individual lender.

If the moneylenders charge their minimum rates and there is a sufficient supply of credit at such rates, nothing very much would be wrong with the rural credit market. The fact, as we have seen in the chapter on rural indebtedness, is that the prevailing rates of interest tend to be very much higher. The real problem then is to explain why moneylenders are able to charge more than the opportunity costs of their capital and labour. First, of course, there is the overall problem of a short supply of credit to the rural sector. Secondly, the existing supply of credit from the Government sponsored credit institutions is insufficient to compete effectively with moneylenders as a class and bring rates of interest down. Thirdly, there are high risks of lending to small farmers, in general and the risk factor would vary with individual borrowers and different purposes and would, therefore, enable the moneylenders to charge higher rates of interest. Finally, individual moneylenders operate in conditions of imperfect competition. The institutional credit system, as stated earlier, offers very little competition. The Chettiars belong to an association which controls their minimum lending rates. This leaves only the Ceylonese Moneylenders, the landlords, the boutique-keepers, the produce buyers and the amateurs to generate any competition in the rural credit market. We have already argued that the non-professional moneylenders have each of them certain advantages which lead to imperfect competition. The ranks of the Ceylonese Moneylenders are also virtually closed by the fact that they lend their own capital and that unless a man has sufficient accumulated capital for the purpose he would not enter the profession. Reasons of occupational immobility and the need to have local knowledge also stand in the way of new operators coming in to the business. Consequently, the rural credit market operates under conditions of imperfect competition.

Government and the small farmer

Government, as was shown earlier, is an important source of secondary finance. It lends money to the CSMB, the AICC and Co-operatives which in turn lend to agriculturists. The amounts outstanding to Government from these credit agencies are shown in Table V. The terms on which these loans are given have already been discussed in the relevant sections.

TABLE V

Government loans to credit agencies

Credit Agency	*Amount outstanding* (*Rs. million*)	*ON*
CSMB	6.0	30. 9.55.
AICC	29.4	30. 9.55.
Co-operative Credit Societies	1.4	30. 9.55.
C.A.P.S. Societies	16.7	31.12.55.
TOTAL ..	53.5	

Source:—Various Annual Reports already cited.

There are a number of other aspects of Government policy which impinge on the finances of the small farmer. They are:—

(*a*) Peasant colonisation and village expansion schemes.

(*b*) The middle class land alienation scheme; and

(*c*) The Rubber Rehabilitation Scheme.

Peasant colonisation, as it is known in Ceylon today, dates back to 1932. Prior to that Government alienated land to peasants who had to bear the costs of development by themselves. Since 1932, a scheme of Government-aided colonisation has been in operation. It is not proposed to go into its history and the various modifications that have been made in the scheme from time to time.[21] At the end of 1955 there were 45 peasant colonisation schemes operated by Government. Each peasant family is given approximately three acres of irrigable land for paddy cultivation and between one and two acres of highland. The land is alienated under the provisions of the Land Development Ordinance No. 19 of 1935 which created a new type of tenure, the principal features of which are:—

1. the allottee is obliged to cultivate the land or utilize it for specified purposes.
2. he makes a nominal annual payment to Government—2 per cent of undeveloped value of the land in the case of peasant colonists, 4 per cent in the case of middle class allottees; and
3. the land cannot be sub-divided below a specified limit and succession to land is regulated for the purpose. The allottee is required to cultivate the block of land allotted to him as a single holding.

Apart from alienating the land, the Government also makes grants to the allottees. The amounts of such assistance has varied from time to time. The present rates[22] of assistance per family are as follows:—

1. Rs. 700 for the construction of a type plan house;
2. Rs. 75 for the construction of a latrine;
3. Rs. 300—Rs. 600 for the construction of a well;
4. Rs. 2 per chain, up to a maximum of Rs. 20 per acre, for soil conservation measures;
5. Planting material up to a sum of Rs. 50.

The land is cleared by Government prior to alienation, each family is entitled to a subsidy of Rs. 200 for stumping and the Government constructs roads to the new lands. The Government meets almost

21. For a comprehensive history and discussion of the scheme see B.H. Farmer *Pioneer Peasant Colonization in Ceylon.*

22 These rates have since been changed. The present rates are:—
—Rs. 155/- for transport of colonist's family and household effects.
—Rs. 30/- as a subsidy for implements.
—Rs. 80/- for a temporary hut pending the construction of a type plan house by Government.
—Rs. 90/- (being the cost of seed paddy provided by Government).
—Rs. 180/- being the subsistence allowance for 6 months.
—Rs. 200/- subsidy for stumping.

all the necessary initial capital expenditure of the colonists. Their subsequent needs are met by loans through CAPS Societies. It would appear that the farmers in the colonisation schemes are well looked after. Nevertheless, they possess only a restricted tenure and can raise loans only from Government on the security of their land. Since most of their developmental needs are met by Government in direct grants, the restricted tenure is no handicap to the development of the land. It is their consumer credit needs which have not been met. Co-operative Retail Societies do function in these schemes but then they do not give credit facilities. Consequently, private traders, of a more affluent type than those in the villages, are known to have set up quite lucrative businesses in these schemes. Nevertheless, the peasants in the schemes are considerably better off than their counterparts in the villages, who have less land, little assistance and very much lower incomes.

Between 1935 and 1955, the Government has granted more than Rs. 50 million in assistance to colonists. The Government also alienates land to middle class allottees under the same restricted tenure, but in larger holdings. The annual rent charged on the land is 4 per cent of it undeveloped value. No direct assistance is given to them but the Government makes an annual provision of Rs. 400,000 for loans to middle class allottees. The loans actually granted are shown in Table VI. The loans are granted for agricultural purposes such as the construction of factories, wells or tanks, the purchase of livestock or agricultural implements, the adoption of soil conservation or flood protection measures and the repayment

TABLE VI

Government loans to middle-class allottees

Year		*Number of borrowers*	*Amount lent (Rs.)*
Upper to 30.9.49	..	72	302,905
1949-50 ..	..	41	247,600
1950-51 ..	..	57	239,950
1951-52 ..	..	58	399,900
1952-53 ..	..	41	276,400
1953-54 ..	..	49	391,760
1954-55 ..	..	95	397,035

Source:—Administration Reports of the Land Commissioner, Ceylon.

of any debts incurred for the development of their holdings. They are repayable in instalments, with interest at 3 per cent over a period not longer than 25 years; normally 60 per cent of the value of a holding is given as a loan. The total amount of loans given each year is small.

Under the Rubber Rehabilitation Scheme the Government grants direct, tax-free subsidies for the replanting of rubber. The subsidy depends on the size of the entire holding on which replanting is to take place. If the area to be replanted is part of an estate of 100 acres or above the subsidy is Rs. 700 per acre replanted; if between 10 and 100 acres it is Rs. 900 per acre replanted; if below 10 acres it is Rs. 1000 per acre. The payment of the subsidy is spread over 4 instalments in the case of estates and 5 in the case of small-holdings below 10 acres in extent in order to ensure that replanting is actually done. Each instalment is paid after a certain specified stage in the process of replanting has been reached. The scheme was inaugurated in 1953 and in its first three years approximately 32,000 acres had been replanted.

To sum up, the Government grants little by way of credit to small farmers directly. It is an important secondary source of credit. In addition, the Government subsidises the peasants in colonisation and village expansion schemes, lends money to middle-class allottees of Government land, and grants subsidies for the replanting of rubber. Thus, each year the Government spends a substantial sum in financing the agriculturist, especially the small farmers.

CHAPTER IX

Conclusion

At the end of Chapter V four questions were posed for answer in subsequent chapters—In Chapter VI to VIII attempts to answer these question were made by discussing the conditions of cost and risk under which the lenders operate and the peculiar advantages enjoyed by some of them.

The basic conclusion which emerges from the foregoing discussion is that the supply of credit to the rural small farmer is unsatisfactory. The Co-operatives which lend at comparatively low rates of interest have made only moderate headway for various reasons which may be summed up under two main headings. First, there is an insufficient number of societies to cater to all farmers. Secondly, even where they exist they do not cater to all the needs of the farmer. The Rural Credit Societies give only short-term loans, and they seem to prefer lending for productive purposes. The CAPS Societies lend to farmers for strictly productive purposes for short and medium periods. Meanwhile, the Retail Societies do not sell their goods on credit. There is thus a wide gap in the supply of credit, namely, the supply of consumer credit, the very type of credit for which the demand is likely to be most inelastic.

Another particularly weak link in the system of credit supply is the inadequacy of long-term credit. Co-operative Land Mortgage Banks are practically non-existent. The CSMB and the AICC supply less than 10 per cent of the mortgage loans in the whole economy. The conditions and terms attached to their loans are such that small farmers find it extremely inconvenient and difficult to obtain loans from them. They are also very inconveniently situated in Colombo, far away from the rural farmers.

The gaps in the supply of short-term as well as medium and long-term credit from the institutional credit system leave the door wide open to the private moneylenders, both professional and non-professional, who supply over 70 per cent of rural loans.

The rates of interest in the rural credit market tend to be high for three reasons. First, the costs of lending are comparatively high. Secondly, the risks of lending are high. Of course, individually a moneylender's risks are not as high as those facing a central lending institution because he has personal knowledge of his customers. Nevertheless, these risks are sufficiently high to warrant the charging of an adequate margin of interest as a kind of insurance cover against risk of loss of capital. These risks and the general shortage of capital combined with the peculiar creditor-debtor relationships in some of the transactions lead to a third reason, namely, that moneylenders are able to enjoy conditions of imperfect competition.

The peculiarities of the rural credit problem make it necessary that any credit system which hopes to operate with success should be able to combine, or at least to co-ordinate, three things, namely:—

(i) supply the consumer requirements of the farmer and his family on equitable credit terms; the period for which the credit is required, being the same as that between one harvest and another, is variable depending on the crop cultivated by a particular family. In normal conditions it would be less than a year,

(ii) supply long, medium and short-term credit for all purposes connected with the process of production,

(iii) provide an organisation for marketing the farmer's crops.

The importance of combining or co-ordinating these three types of activities arises because the farmer's credit needs are connected with his consumer, producer and marketing requirements. His position is vulnerable at all three levels of his consumer-producer existence.

CHAPTER X

Recent Developments

Chapters I—IX of the Study were completed by the end of October, 1957, as stated in the Preface. Some of the data used in the Study as well as some of the criticisms and opinions expressed are not altogether valid in view of more recent developments. In this Chapter it is proposed to outline some of the more important developments impinging on the subject of agricultural credit in Ceylon and to refer to their relevance to the views expressed in the body of the Study. These developments will not be discussed in detail. The purpose of the Chapter is merely to focus attention on such changes. The changes have been of a far reaching kind and it is as yet too early to pass judgement on their effects.

The basic structure of agriculture as described in Chapter II has not altered very much in the interim period; nor has the occupational pattern or the pattern of land ownership varied significantly.

Rural Indebtedness

More recent data on rural indebtedness have become available. In 1957, the Department of Census and Statistics with the help of the Departments of Co-operative Development and Agrarian Services conducted a survey of rural indebtedness[1] with a view to providing the basic data required for the preparation of the *Agricultural Plan*[2] of the Ministry of Agriculture, Co-operatives and Food. The general conclusion in Chapter III that if data were available for a normal year, rural debts would have been higher than and the pattern different from the position as revealed by the 1950/51 data has been borne out. In 1957, 54% of rural families were in debt in contrast to 30% in 1950/51. The average debt per family had increased from Rs. 263/- to Rs. 750/-. The estimated total debt of the rural sector had gone up from Rs. 95 million in 1950/51 to

1. Department of Census and Statistics, *Survey of Rural Indebtedness in Ceylon.*
2. Ministry of Agriculture, Co-operative and Food, *Agricultural Plan*, 1959.

Rs. 516 million in 1957. The general picture revealed at the 1957 survey was one of higher incidence and burden of debt than shown by the 1950/51 survey.

The indebtedness data for 1957 also included data on sources of credit which are shown in Table I, below:

TABLE I

Sources of rural credit, 1957

Source	*Percentage of total debt*
Government	2.6
Co-operatives	4.1
Commercial Banks	1.1
Relations and friends	44.2
Landlords	8.0
Professional Moneylenders	15.5
Traders and Commission Agents	11.5
Others	13.0
	100.0

Source:—D.C. and S.—*Survey of Rural Indebtedness in Ceylon*, 1957.

The salient feature revealed by this data is that despite some fifty years of existence, the Co-operatives have made very little headway in providing credit to the rural sector. In fact, institutional lenders, i.e., Government, Co-operatives and commercial banks, accounted for only 7.8 per cent of the total debts. The bulk of the debts came from relations and friends. These data serve to confirm our view expressed in Chapter III that the rural sector was financed largely from private sources. The reasons for this have already been examined in earlier Chapters.

Important Recent Developments

There have been three significant developments impinging on agricultural credit in Ceylon since the writing of the original Study, namely—

(*a*) The Paddy Lands Act No. 1 of 1958.

(*b*) The establishment of a large number of Multi-purpose Co-operatives, and,

(*c*) The establishment of the People's Bank.

The Paddy Lands Bill to which we made reference in Chapter V became law in 1958 and the comments made in that Chapter in regard to insecurity of tenure of *Ande* tenants are not quite true now. Under the Paddy Lands Act, an *Ande* tenant gets a heritable tenancy right and the share going to the landlord has been limited to one-fourth the gross yield or a specified number of bushels of paddy per acre (not exceeding fifteen) whichever is less. The Act was extended in stages to different areas of the country. It was extended to cover the entire country only in 1963. An assessment of the effects of the Paddy Lands Act on paddy yields has not been undertaken, but from our point of view, heritable tenancy confers greater security of tenure and the land cultivated by a tenant will become more suitable as security for lending.

The basic conclusion of our study, as stated in Chapter IX, was that it was important to co-ordinate the supply of consumer credit, producer credit and marketing organisations for rural products. The Survey of Rural Indebtedness in 1957 served to focus greater Government attention on this problem of supplying the credit requirements of farmers and it was adopted as a matter of Government policy that the more suitable form of co-operatives for the rural sector was the multi-purpose co-operative society. In pursuance of this policy a large number of multi-purpose co-operatives were established and the single-purpose co-operatives were converted into multi-purpose co-operatives combining in them the functions of retail selling, rural credit and the marketing of rural products. By the end of 1962, there were 4912 multi-purpose co-operatives, having a membership of 797,603 and a total working capital of Rs. 66 million. Multi-purpose co-operatives have taken on the credit functions performed by the CAPS societies described in Chapter VI. The success which the new type of co-operatives has had in providing agricultural credit cannot now be assessed with any certainty until a further survey of the rural debt position is undertaken.

The policy of establishing multi-purpose co-operatives also focussed attention on the need for a central financing organisation providing credit to multi-purpose co-operatives for their activities in the rural sector. As described in Chapter VI, the Co-operative Federal Bank was acting as an apex bank to the co-operative movement, but the bank's operations were small. In the *Agricultural*

Plan of 1959 a great deal of emphasis was placed on the question of providing agricultural credit. A sub-committee of the Planning Committee[3] of the Ministry of Agriculture examined in detail the position regarding rural credit. Arising from the recommendations of this sub-committee it was decided to expand the activities of the Co-operative Federal Bank by establishing a new institution. It was also realised that such an institution could not survive by providing credit to the rural sector alone. Hence, the People's Bank was established in July, 1961 as a full-fledged commercial bank, but with specific powers and facilities for providing credit to the rural sector. The Bank has now existed for over 2 years, and at the end of 1962, it had established 24 Branches and had attracted to itself Rs. 153.9 million of deposits.

The People's Bank has also entered actively into the field of pawn-broking which was, in fact, a function which the Banking Commission of 1934 had assigned to their proposed State-aided Bank.

A point made in Chapter VIII bears repetition at this stage. The usufructuary mortgage as a suitable method of lending in the rural sector was discussed in that chapter. In particular, reference was made to the feasibility of using this type of mortgage in a modified form in the rural sector. This might prove to be a useful method by which the services of the People's Bank could be extended to the rural sector.

The People's Bank also appears to be attempting to lend to rural borrowers at low rates of interest. This is indeed a laudable objective but two matters need to be considered. First the rural sector is borrowing at high rates from private moneylenders and rates as high as even 12 to 15 per cent would be low in comparison. Secondly, the People's Bank is admittedly taking high risks. In the circumstances the necessity for and wisdom of lending to the rural sector at rates as low as 6 per cent appear to be doubtful.

Apart from these general comments it is not possible, at this early stage of its existence, to pass any judgement on the success of the People's Bank in providing credit to the rural sector.

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3. The Author was co-opted as a member of this sub-committee.

With the establishment of the People's Bank and the multi-purpose co-operatives the institutional framework required for a greater supply of credit to the rural sector has been largely provided. The mere provision of the institutional framework can only make possible a greater supply of rural credit. There are, however, several other factors hampering the free flow of credit to the rural sector connected with the lack of suitable security, high risks of agricultural production and the low level of rural incomes. Crop insurance which is being tried out in an experimental way should help in reducing the risks of production. There were several other proposals in the *Agricultural Plan* which were designed to tackle the major economic problems in the rural sector but these have not been pursued.

This study has been concerned only with the credit problems of farmers. An adequate supply of credit is a necessary condition for rural economic development but it is not a sufficient condition. The mere supplying of credit cannot achieve development but the lack of it is bound to hamper development. An adequate supply of credit is an essential aspect of any programme for rural economic development.

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