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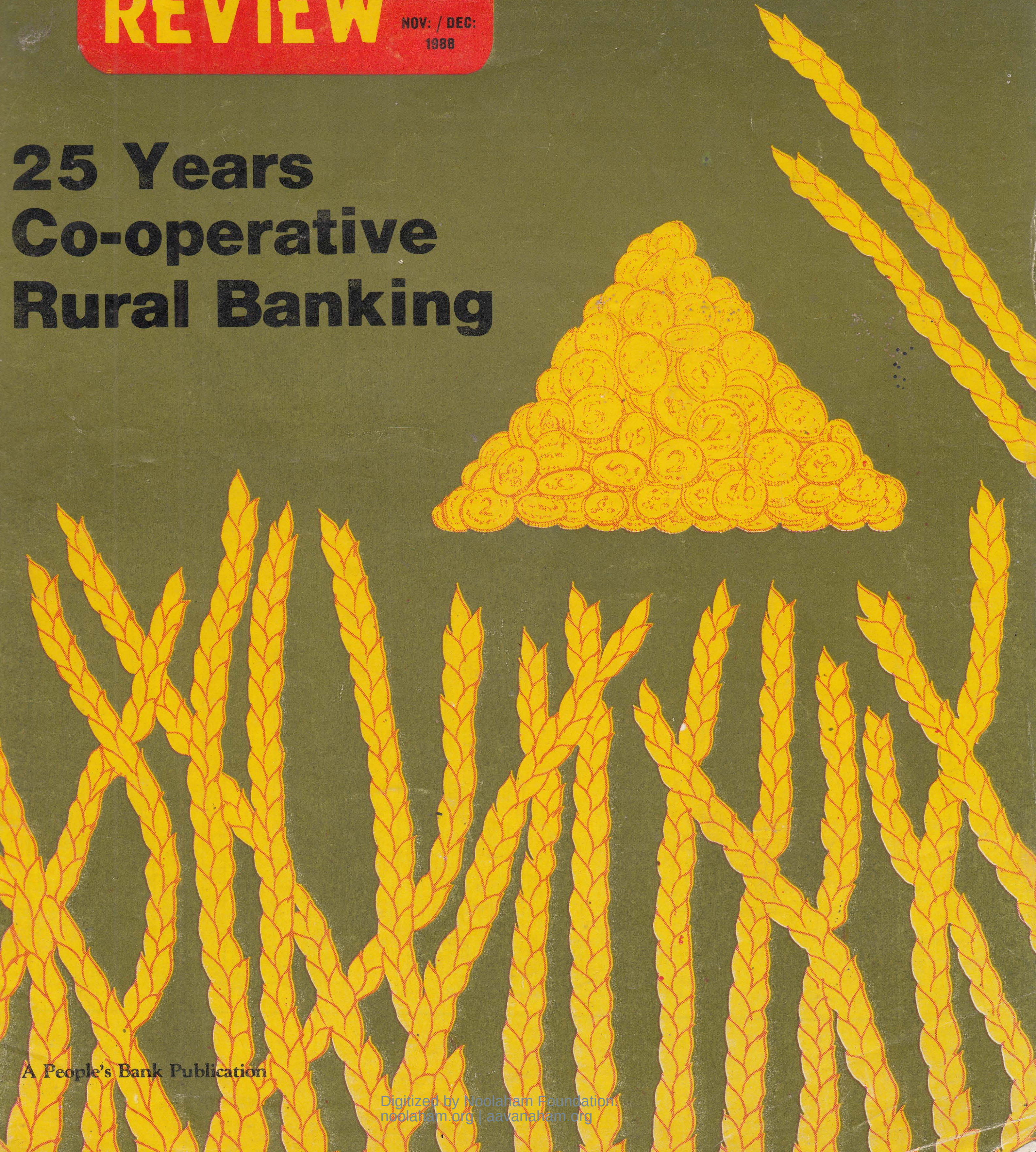
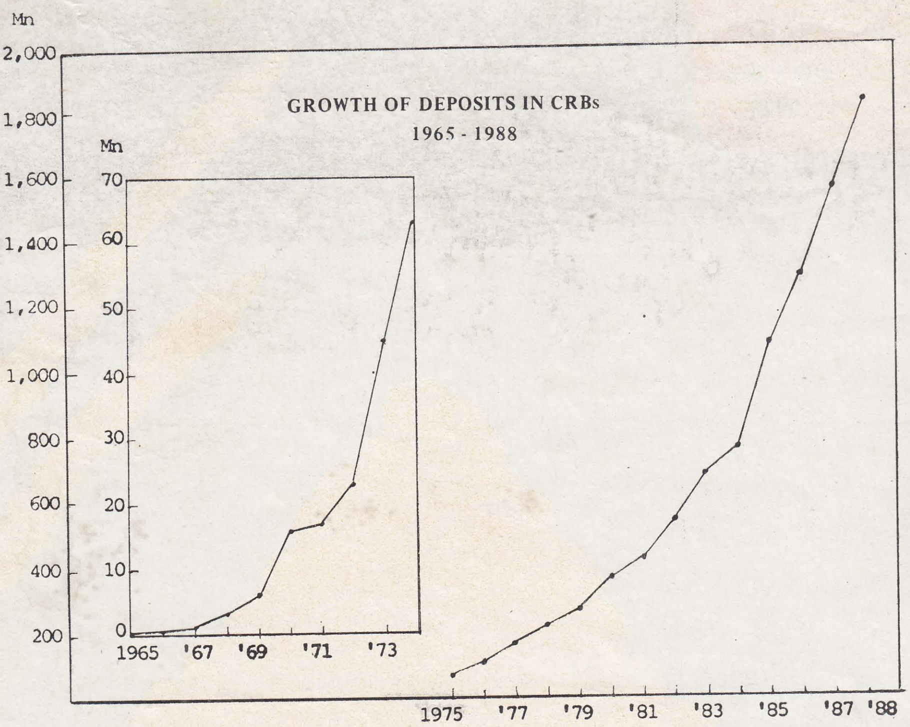
25 Years Co-operative Rural Banking



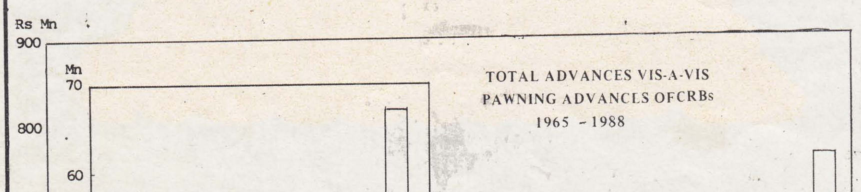
A People's Bank Publication

CO-OPERATIVE RURAL BANKS – AT A GLANCE

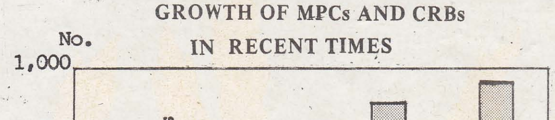
Origins, Growth, Deposits and Advances



The Menikhenna Rural Bank – the first Co-operative Rural Bank, opened on March 26, 1964



GROWTH OF MPCs AND CRBs IN RECENT TIMES



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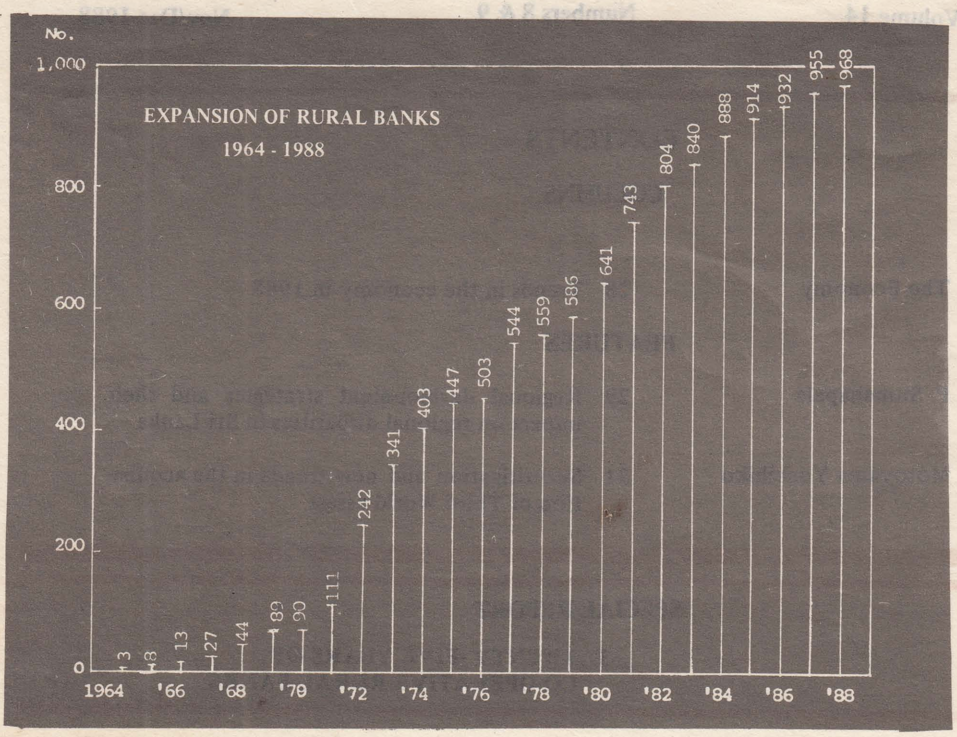
COVER ARTIST

Sebastian Peerez



TWENTY-FIVE YEARS OF CO-OPERATIVE RURAL BANKS

In March 1989, the Co-operative Rural Banks (CRBs) celebrate their 25th anniversaty. In early 1964, when this scheme was inagurated by the People's Bank it was considered an adventurous move, and there had been widespread scepticism about its success even within the Bank. Yet the GRBs steered their way through to withstand these challenges, and also proved to be a true partner in rural development in many ways (See paper by Dr. Nimal Sanderatne, pages 15-17).

In this Special Report, the concept of CRBs, its evolution, strengths, challenges and some clues for their future direction are discussed by a team with specialised experience and background of this area. It is hoped that these articles would provide a closer insight into the origins and progress of the CRB's, their contribution to the development of the country in general and to the rural sector in particular.

A Profile of CRBs

The rural sector occupies an important position in the Sri Lankan economy. As much as 75 percent of Sri Lanka's population lives in the rural sector which provides them with food, shelter, and employment opportunities and the basic means of livelihood. Its contribution to the GDP, export earnings, and also to the capital formation of the country cannot be underestimated. Moreover, the vastly untapped development potential in this sector, together with the social obligations to uplift the living standards of the rural population makes this sector all the more important in the development process. It is in this context that the signigicance of the commemoration of the 25th anniversary of the CRBs should be viewed.

The last 25 years have recorded dramatic changes in the country's social fabric and witnessed many changes in the Sri Lankan economy and resultantly in the banking system of the country. Naturally, CRBs also had to face these socio-economic undercurrents and perhaps change their ways to suit the situation. Whether these institutions have been successful in this process is an open question. Yet, the fact that they have been able to sustain themselves and continue to grow may in itself be considered an achievement. A cursory look at the evolution and the growth of the CRBs shows a steep and sustainable increase in the number of banking outlets, and also their business turnover. The growth in number of CRB branches, as depicted in the Graph, which moved at a rather cautious space until 1973, accelerated thereafter to reach 968 branches operating in various parts of the country by 1988. Of these about 282 were full-fledged CRBs, while the balance 686 were special branches providing limited operations. How many of these branches are really rural? Given the complexities in the definition, of what is rural and what is not, this kind of assessment may not be easy. However, it was found that about 13.8 percent of the 968 branches were located in predominantly backward, rural districts like Moneragala, Hambantota and Mullativu. (See Table on P.14). Another 45.9 % of the branches were located in rural districts like Badulla, Kegalle and Kurunegala. The next category of districts include those once having a bigger urban fringe, such as Gampaha, Kalutara, and Jaffna. About 33.7 percent of the branches fell into this group of districts, while the Colombo district alone constituted 6.4 percent of the CRB branches.

Of course, this kind of classification may appear to be rather crude, but it gives a relative positioning of districts and the concentration CRB branches into each category of districts. It should be noted that even within these districts the CRBs may tend to concentrate into more urbanized areas than towards the real rural hinterland. An important inference one could make from such a classification would be that quite a substantial number of CRB branches are still located in the urban areas and not exclusively in the rural areas.

Another important performance indicator of the CRBs has been deposits collection. The deposits volume of CRBs grew from a meagre Rs.496,360 in 1965 to Rs. 1.83 billion in 1988. The average growth rate of CRB deposits has been closer to 50 percent per annum which is far in excess of the average rate of growth of deposits of the country. In this sense, CRBs have been a remarkably effective deposit mobilizer. They have been equally competitive in both tremendously under-banked rural areas, as well as highly over-banked rural areas. For instance about 10 percent of their total deposits have come from the Colombo district alone; while another 41 percent of these deposits have come from the districts of Gampaha, Kalutara, Galle, Jaffna and Kandy. All these districts have reached relatively higher levels of sophistication in terms of the standards of facilities offered and the spread of banking habits which made these districts and their depositors more exposed to competitive commercial banking sources.

Another interesting feature of the deposit mobilization scheme of the CRBs has been that the bulk of the depositors are small savers whose deposits range from between Rs.25 to Rs.500. In this sense the market nitch of the CRBs has been the small time depositor, whose average balances of savings deposits has been around Rs.700. By September 1988, the CRBs had deposit accounts amounting to 2.34 million. In this sense the market nitch of the CRBs has generally been those depositors who are not entertained by the commercial banking system of the country. The fact that even non-members of the CRBs are eligible to open deposit accounts makes CRB deposit mobilization schemes much more effective. The maintenance of a large number of small accounts is in fact a relatively non-rewarding exercise if not for the relatively low administration cost of the CRB operations. It is precisely this low administration cost of maintenance of deposit accounts that has made CRBs so fiercely competitive in the mobilization of rural deposits.

The other side of the coin of the CRB operations is the loans and advances. The CRBs have right from the beginning set as its objective catering to the overall financial needs of the rural sector of this country. In order to achieve this goal a comprehensive package was designed to include, various possible credit needs such as agriculture industry, consumption, housing, rural electrification etc. In the first few years of operation of the CRBs, these advances have always been in excess of their deposits, with the difference between advances and deposits being regularly provided by the People's Bank. This process continued until 1975, after which year the deposit levels began increasing at a faster rate than advances. There have been many reasons for this development (See articles on CRB investments). Yet the credit promotion of the CRBs has not been as effective as their deposit mobilization operations and this has become a blind spot in their services to the rural sector.

There have been many critisisms levelled against the CRBs for their inability to plough back CRB funds to the rural sector itself. Although the problem of extraction of surpluses by the banking system has been raised on many public platforms it has neither been adequately studied nor properly, discussed. Some of the questions that have often been evaded by the surplus extraction school include:

(i) how clear are we about the demarkation of boundaries of rural areas vis-a-vis urban areas?

(ii) how many of the so-called rural depositors are really rural, and how much of their savings consist of the total savings of the Rural banks?

(iii) what are the expectations of the rural savers?

(iv) what is the real size of the credit gap in the rural sector, and what causes have prevented prospective borrowers from coming to the CRBs?

Classification of Advances.

A purpose-wise classification of CRB advances presents a few interesting features. The low exposure of the CRBs to finance the working capital requirements of direct production related economic activities is the most interesting of them all. The direct production related economic activities in the rural sector include small farming, animal husbandry, rural industry etc. which provides the livelihood for the rural majority. However, advances to agriculture and related operations by the CRBs consist of a meagre 15.3 percent of their total outstanding loans, while the advances to the industrial sector cover a marginal 4.9 percent of the total loans. Secondly, over the years the growth rates of advances to this sector seem to have beenoccurring at a pace very much disproportionate to their relative performance in the Sri Lankan economy.

A sector that has been adequately covered in the credit operations of the CRBs portfolio has gone into the sector of housing, in 1988. The importance of this sector in the credit disbursal of the CRBs has been quite consistent during the past few years. The relatively high exposure of CRB loans to this sector synergises with the recent upsurge in the investments on housing in the country. On the other hand, from the point of view of the borrowers, housing loans have become the most easily obtainable credit type available in the CRBs.

Pawn brokering has become the single most important credit type offered by the CRBs in the eyes of the borrowers. This category of borrowings has become attractive because of its absence of formalities and timeliness of operations. As much as 50 percent of the total advances of Rs.764 million consisted of pawn brokering and the use of this facility continued to grow despite the suspension of pawn brokering operations in quite a large number of CRBs in various parts of the country.

The market place of the CRBs and the external influences on its investment climate have been quite turbulent during more recent times. This includes the virtual removal of the state patronage and shelter from the Co-operative Movement, the re-introduction of the operations of the free market forces in banking operations and the institution of a few competitive arrangements such as RRDBs, TCCS based Rural Banks, and the appointment of Agency banking outlets popularly known as PNNs, which have made the business of CRBs much more challenging than ever. These new challenges have influenced the CRBs to rethink their age old opproaches to business, and conventional linkages with outside bodies. (For an overview and possible future directions for the CRBs, see paper by Mr. M.W.Panditha, pages 9 - 13).

The approaches to business operations of the CRBs covers a very wide area. Some of the integral parts of its coverage includes the organizational structure, management styles, systems and procedures etc. some of which are discussed in a separate paper (See paper by Sunil Wijesinghe). The linkages of the CRBs even include, its relationship with the People's Bank — their creator; the MPCSs; the State-through the Department of Co-operative Development; and other institutions.

There have been many committees set up to report on their coordination and studies carried out on these linkages. The suggestions of these various committees in a rhetorical sense boils down to a variety of options ranging from separation, to consolidation to regroupings and in extreme cases to winding up. However, in a very broad sense, the CRBs seem to need a re-structuring of one type or another. Such a restructuring would engulf not only its linkages with the outside world environment but also with those components that are internal to the CRBs.

U.V.

ORIGINS OF COOPERATIVE RURAL BANKS AND THEIR EARLY YEARS

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The Rural Banks Scheme started by the People's Bank in 1964, through the Multipurpose Co-operative Societies, after three years of the Bank's operation, was aimed at expanding banking facilities among the rural population and thereby intensifying economic activities in the rural sector. This was considered an essential step in the People's Bank's programme of mobilizing rural savings for rural credit through the Co-operative Movement. At a time when almost all the existing commercial banks' services offered were mainly outside the rural sector, the beginning of the Rural Banks Scheme, which was devoted to the development of the rural sector, was an innovation in the country's banking system.

People in the rural sector, who represented about three-fourths of the population in the country at that time, were engaged mainly in small scale farming, and other economic activities such as fishing, handicrafts, other cottage and small industries and trading; and they made a considerable contribution to the national economy. These people in the rural sector obtained their financial assistance at a higher cost, as it came mainly from the informal money market. The only significant institutional credit source was the village Co-operative which provided short term credit facilities to a very limited level but at a lower price.

The history of the financial assistance from the Co-operative sector can be traced back to the beginning of this century. In 1906 there were two known Co-operative Credit Societies at Teldeniya in the Kandy district and at Weligama Korale in the Matara district.

Beginnings of Co-op Credit

The Agricultural Banking Committee appointed in 1909 pointed to the seriousness of indebtedness in the traditional rural sector. This Committee advised that Co-operative Credit Societies be established as they would give credit at a reasonable price to the village farmer, who could then invest in his economic activities and earn a reasonable profit. The Co-operative Credit Societies were legally established only after 1911 under the Co-operative Credit Societies Ordinance No. 7 of that year. The first Co-operative Credit Societies under this Ordinance was of the unlimited liability type, where the members of these Societies were individually and jointly liable for the debts of the Society. The first society of this type was formed in 1912. There were two types of other Co-operative Societies in this early period namely (i) Co-operative Credit Societies of limited liability and (ii) Co-operative Thrift and Savings Societies. Co-operative Thrift and Savings Societies mainly comprised of government servants and therefore these societies largely catered to them. Although the main objective of these Societies was savings promotion, they also granted loans upto 75 percent of savings. In later years a good number of these societies were transformed into credit societies of the limited liability type and thereby the credit accessibility of these members was expanded. The Co-operative Credit Societies of limited liability were basically located in urban centres and served the middle class people, like traders and small industrialists, in these areas; though these societies had some roots among village farmers too. Only the Co-operative Credit Societies of limited liability helped the rural farmer by providing him institutional credit even to a limited extent. Over the years all these types of credit societies increased in number, and so did their membership and the amount of loans they granted. For example the total number of credit societies of unlimited liability, Credit Societies of limited liability, and Thrift and Savings Societies increased from 315 in 1926 to 1786 by 1942. The membership of all these societies (including other types) increased from 41,164 in 1926 to 91,988 by 1942. The resources of these societies were not sufficient to cover the granting of credit and therefore to meet this gap in funds they obtained funds from the Local Loans and Development Fund established in 1916 by the government.

In the late 1920s the State Mortgage Bank was set up by the government to provide long term credit facilities. But the small farmer in the village could not benefit from the facilities of this bank since it was operated from Colombo, and had no branches in rural areas. Also, it adopted a strict standard of valuation and examination of land titles on which mortgage loans were granted by this bank.

Co-operative Banks

With the formation of Co-operative Banks at the end of the 1920's a new period was started in the Co-operative Credit system. These banks were called Co-operative District Banks or Co-operative Provincial Banks, and were formed by affiliating the Primary Co-operative Credit Societies in the respective areas and regarding these societies as the members of the banks. While these banks accepted time and savings deposits from the Co-operative societies as well as the public, demand deposits were accepted only from the Co-operative societies. The first Co-operative Bank – The Central Bank of Jaffna – was set up in Jaffna in 1929. During the next two years another two banks were set up in Kandy and Colombo. By the beginning of the 1960's there were 4 Co-operative Provincial Banks and 11 Co-operative District Banks in the country. However with the increase in number of Co-operative Credit Societies there was a feeling that an apex bank, to serve the entire island's Co-operative sector was needed.

The Banking Commission of 1934 which examined the Co-operative Credit system accepted that this system had developed satisfactorily and it was this institutional credit system that served the "natives" since the British based exchange banks, at that time, served only the export oriented Plantation and Commerce sectors. The Commission furtive Central Banks may be setup, an apex bank for the Co-operative sector was not necessary. Instead of an apex bank, they suggested that Co-operative Societies could deal with a state aided indigenous commercial bank which they recommended should be set up. The Bank of Ceylon, the first local commercial bank, was set up in 1939 on the suggestion of this Commission and others. But it failed to associate directly with the Co-operative Societies as originally envisaged. It had very little connections with the rural sector and soon became another export sector oriented commercial bank.

During World War II when the country had to undergo a severe food shortage the government attempted to use the Co-operative system to solve that problem. Co-operative Stores Societies were set up throughout the country to distribute limited supplies of commodities, and Co-operative Agricultural Production and Sales Societies (CAPS) were established to encourage local food production. Although the main function of the CAPS was to purchase food commodities under the Guaranteed Price Scheme (GPS) these societies were used as agents by the government to channel the loans for cultivation purposes to the farmer. The number of these Co-operative Societies as well as their membership increased rapidly upto 1957 though they were basically state creations rather than voluntary organisations.

Co-op Apex Bank

The setting up of the Co-operative Federal Bank of Ceylon Ltd., an apex bank to the Co-operative Sector, was a further development in the Co-operative Credit System. The failure of the Bank of Ceylon to deal directly with the Co-operative Sector, particularly the development of the Co-operative Societies and the Co-operative Provincial and District Bank led the way to establishment of the Co-operative Federal Bank by the late 1940's. The Federal Bank was registered under the Co-operative Societies Ordinance of 1936. It's objectives were to carry on banking and credit business, to act as a balancing medium for the surplus funds of societies, to supervise inter-lending among Societies, and to provide educational assistance to the staff of the Societies. The Co-operative Provincial and District Banks, the Co-operative Societies and a limited number of individuals were eligible to become share holder members of the Banks. The capital of the Bank was composed of shares, deposits, loans and profits. The Bank received financial assistance from the government by way of loans; and it was granted an initial loan of Rs.2 million in 1949; and an additional loan of Rs. 4 million in 1953 by the Government. Basically, the Bank could grant loans to the Provincial and District Banks and to the Primary Co-operative Societies in areas not served by Provincial or District Banks, and also to the Primary Co-operative Societies which served more than the area of one Provincial or District Bank.

Though there were many hopes in the Federal Bank it was later realized that it could not carry on banking and credit business efficiently mainly due to its structural weaknesses. The Federal Bank could not sufficiently provide credit facilities to the Co-operative Provincial and District Banks and Co-operative societies due to a lack of resources this Bank faced. The Federal Bank could not attract all the deposits of the Co-operative Societies due to the insufficiency of legal provisions for that purpose; it could not raise funds on debentures since no guarantee was provided by the government; it could not raise share capital since the Co-operative Banks and Societies bought shares not as an investment but merely to become eligible for loans; and it could not earn a good profit due to a variety of reasons such as an insufficient gap in the interest between its borrowing (3 percent) and its lending (3½ percent – 4 percent), and funding on high risk agricultural activities without government guarantees. After several years of operation the Federal Bank found that its business with the Co-operative Societies was decreasing. Over the late 1960's deposits made by the Co-operative Societies in the Federal Bank and loans granted by the Federal Bank declined dramatically. The Federal Bank was not able to win the confidence of the Co-operative Provincial and District Banks and Co-operative Societies in order to either act as a balancing medium for surplus funds of societies or to supervise lending among Societies due to the lack of skilled and experienced personnel in the Board of Directors of the Federal Bank. In most cases the directors acted in favour of the Co-operative Societies they represented, rather than in the interest of the Federal Bank or Co-operative Credit system as a whole. The Federal Bank also could not provide any educational assistance to the staff of the Co-operative Societies since the Bank did not have necessary staff for it.

Survey of Rural Indebtedness

By the late 1960's the Co-operative Credit System as a whole could meet only a very limited part of credit requirements in the rural sector. The Survey on "Rural Indebtedness in Ceylon" 1957, disclosed the gravity of this problem. According to the Survey 54 percent of the village families were in debt and the average debt of a village family was Rs.750/-. Total debt of the rural population was estimated at over Rs.500 million at that time. The survey also revealed that out of this total debt only 4.1 percent was due to the Co-operative Societies; and only 2.6 percent and 1.1 percent, respectively, were due to the Government and Commercial Banks. The remaining large majority (92 percent) of debt was due to non-institutional sources like professional money lenders, landlords, boutique keepers and traders.

Based on this survey in 1957 the Co-operative Movement was reorganised by amalgamating Single Purpose Co-operative Societies into Multipurpose Co-operative Societies (MPCS) which were expected to do village banking by providing credit and organising savings in the rural sector. Among the package of facilities they were due to provide were services such as marketing of produce; provision of consumer goods, agricultural inputs, stores facilities, employment for members etc. The MPCS was expected to function as a primary rural bank to stimulate economic activities in the rural sector.

Establishment of People's Bank

With the introduction of the MPCS system there was a crying need for a specialised credit institution with high efficiency, structural strength, and adequate financial ability to support the Co-operative Movement in achieving its aims and for developing rural banking and agricultural credit. After much discussion, debates and controversy over a number of years in and among the various institutions like the Ministry of Agricultural and Food, the Central Bank of Ceylon, the Cabinet of Ministers and the Parliament, the People's Bank Act No. 29 of 1961 was passed and the People's Bank was set up in the same year to meet the above needs. At the commencement of the People's Bank the Co-operative Federal Bank was dissolved and its assests and liabilities taken over by the People's Bank. Nine out of the 15 Co-operative Provincial and District Banks that existed at that time were turned into branches of the People's Bank. The People's Bank was empowered to be a viable financial institution by providing it (1) Government participation in holding 50 percent of shares of the Bank (while the balance 50 percent of the shares were allocated to the Co-operative Societies). (2) the statutory requirement that all Co-operative Societies deposit their funds only with the new Bank. (3) powers to the Bank to engage in commercial banking activities and practice, (4) powers to the Bank to obtain government funds or outside debentures with a government guarantee.

The purposes of the new Bank as stated in the People's Bank Act were to develop the Co-operative Movement of Ceylon, Rural Banking and Agricultural Credit by furnishing financial and other assistance to Co-operative Societies, Cultivation Committees and other persons. The Bank was also expected to set up a network of branches throughout the country, particularly in the rural areas, to assist the vast majority of the people to promote economic growth and to transform the rural economy.

Soon after its establishment the People's Bank realised that it was not feasible to extend its branch banking to the remote areas where the bank had to incur a high operational and administrative cost, with a higher risk, to continue a direct relationship between the branch bank and the individual small farmer. This was due to the peculiar characteristics of the rural economy and the peasantry,such as a lack of bankable securities and uncertainity and irregularity in their income. The bank was also informed during its initial stages of operation that though it opened a number of branches in rural areas, which were not yet served by the Commercial Banks, these facilities were enjoyed mostly by the fixed income earners among low income levels and some middle class people in these areas.

Emergence of Co-operative Rural Banks

The People's Bank, with the purpose of overcoming this problem, started a new loan scheme, the Extended Rural Credit Scheme, in 1963 through selected MPCSs on an experimental basis. Under this scheme the People's Bank granted overdraft facilities to the selected MPCSs for re-lending to their members for a variety of purposes. However, this scheme too did not workout satisfactorily to fulfill the aims of the Bank in meeting the credit requirements of the rural sector through the MPCSs at a comprehensive level. The failure of this scheme and some experiences gained through it led the People's Bank to formulate a device to provide the required banking services to the rural sector through Co-operatives, and the final result was the setting up of the Rural Banking Scheme in 1964.

The Rural Banking Scheme was a more ambitious one than the extended Rural Credit Scheme The duration of operation of the Rural Banks may be divided into two main phases, namely:

(1) from 1964 to 1971, the initial period on an experimental basis;
(2) the period from 1972, when operations underwent a rapid expansion.

The People's Bank was allowed to open up Rural Banks only in selected Co-operative Societies during the initial period. The Bank conducted surveys, investigations and inspections in selecting societies, although selections were also made on the recommendation of the Department of Co-operative Development. Among the eligibility criteria applied in selecting societies to ensure efficiency and viability included the following: (i) large membership of about 400, (ii) regular payment of their share capital by members (iii) good record of repayment of loans taken from Government Departments or other institutions (iv) operating with profits for at least three years (v) it's housing was satisfactory from a security point of view. Priority was also given to the societies which were operating the Extended Credit Scheme successfully and maintaining consumer sections and acting as an agent under the Guaranteed Price Scheme for the purchase of paddy.

A Rural Bank was not a sophisticated bank in the conventional sense; it was started only as a banking unit – a credit and savings department – of the Multi Purpose Co-operative Society. Since the Co-operative Bank was a part of the MPCS, it did not have a seperate legal entity and it was governed by the by-laws of the MPCSs. During the initial stage, once an MPCS was selected for setting up of a Rural Bank the Society had to enter into an agreement with the People's Bank to set out the necessary terms and conditions under which the Rural Bank was expected to be operated. Also, the selected MPCSs had to make some amendments in their by-laws to provide the legal grounds on which the MPCS could set up a Rural Bank. The Co-operative Bank had to obey orders and instructions issued from time to time by the Co-operative Development Department, and the People's Bank as well. A Rural Bank did business in the names of its MPCS while in the case of pawn broking business it acted as an agent of the People's Bank.

Rural Banks were often housed in the MPCS buildings and the staff of the Banks were also a part of the staff of the MPCS. The staff of a Rural Bank consisted mainly of the Bank Manager (the Credit Manager) and a few assistants depending on the volume of activities in the Bank. The administration of the Rural Bank within the MPCS was done by the Board of Directors of the MPCS, through its General Manager.

Objectives and Functions of CRB's

The Rural Banking Scheme could be considered an effective instrument devised for extending credit facilities and mobilizing savings, even to a limited extent in the rural sector, and for contributing towards speeding up economic activities in this sector. The original main objectives of setting up of the Rural Banks included:

1. Provision of credit facilities in an effective manner to the low income segments in the rural sector.
2. Mobilization of savings in the rural sector in a well organised manner.
3. Providing adequate and detailed supervision of the credit facilities granted.
4. Improving efficiency in documentation and accounting systems.
5. Improving banking practices among the population in the rural sector.

To achieve these objectives the following functions were expected to be fulfilled by these institutions:

(1) Granting credit to the members of the MPCS for a wide variety of purposes, within the approved limits for each purpose;
(2) Accepting deposits from members and non-members;
(3) Provision of pawn broking facilities to members and non-members;
(4) Linking credit with marketing.

Under the Rural Bank Scheme financial assistance was available to members for purposes of production (including agriculture, animal husbandry and cottage industries); housing; debt redemption; trade; consumption; electrification and other purposes, including emergencies. During the initial period the Co-operative Banks did not grant facilities for paddy production since a loan scheme for paddy production was being operated by the government through the MPCSs. At the initial stage maximum loan limits were fixed according to the purposes of the loans, that is, Rs.2,500/- each for production and Rs.200/- for emergencies. The loan facilities consisted of both short-term and medium term loans ranging upto five years, and the maximum duration

DEPOSITS AND ADVANCES OF RURAL BANKS 1965–1971

End of Year	No. of Banks	DEPOSITS						ADVANCES						Differences between deposits and advances in Rs.'000
		Savings Deposits		Fixed Deposits		Total		Short-term loans		Pawning		Total		
		No.	Amount in Rs.'000	No.	Amount in Rs.'000	No.	Amount in Rs.'000	No.	Amount in Rs.'000	No.	Amount in Rs.'000	No.	Amount in Rs.'000	
1965	8	2,924	492	9	5	2,933	496	1,153	915		253		1,167	– 670
1966	13	4,634	703	15	23	4,651	726	1,783	1,327	4,222	427	6,005	1,754	– 1,028
1967	27	8,792	1,306	41	65	8,833	1,371	2,897	2,029	6,598	633	9,495	2,663	– 1,291
1968	44	17,359	3,111	287	223	17,646	3,333	5,586	3,631	9,507	1,086	15,093	4,716	– 1,383
1969	68	28,626	5,713	724	461	29,350	6,173	7,893	5,572	14,325	1,524	22,218	7,096	– 922
1970	90	49,936	16,109	892	799	50,831	16,908	10,017	7,122	18,092	1,980	28,109	9,102	+ 7,806
1971	111	60,371	17,188	838	676	61,209	17,864	10,725	7,144	21,044	2,172	31,769	9,317	+ 8,548

of repayment was decided according to the purposes of the loans. Rural Banks also operated pawn broking from the beginning as authorised agents of the People's Bank.

The Rural Banks opened Savings Deposit accounts and Fixed Deposit accounts for both members and non members. Members were encouraged to deposit in their accounts at least a part of the cash they received from selling their produce to the Society. Members were granted credit through their Savings Accounts but not directly. Although Current Accounts were also opened to the members at the very beginning of the Rural Bank Scheme they were compelled to withdraw this facility quickly due to certain legal problems.

Though the Rural Banks were started as Departments of the MPCSs they had a unique link with the People's Bank in their organizational system. The People's Bank continued to extend its fullest co-operation to the Rural Banks by way of financial, managerial, supervisory and other assistance. It provided funds to the Rural Banks in the form of both overdraft facilities and term loans for re-lending to the members of the Rural Banks. In the early years loans granted by the Rural Banks exceeded the deposits made in them and the difference was provided by the People's Bank. The People's Bank employed a member of its staff to advise and assist each of them on all aspects of the business conducted by the Rural Banks. Training facilities were provided to the Credit Managers of the Rural Banks at the branches of the People's Bank. A monthly checking was conducted by the nearest branch of the People's Bank; while regular inspections were carried out by the Head Office of the Bank. The Rural Banks were required to regularly provide performance reports and statistics on their business to the People's Bank. The People's Bank also provided safes, counters, stationery and equipment for pawning to the Rural Banks, on easy credit terms.

CRB's advantage over Commercial Banks

In providing even limited banking services to the rural sector the Rural Banks were at a certain advantage over the branches of the commercial banks. The Rural Banks were running at a lower operational cost than the Commercial Banks. For instance, Rural Banks were very often housed in the MPCS building and staff which was a part of the MPCS staff was provided at much lower salaries and other economic benefits compared to that of commercial banks. Unlike the commercial banks, rural banks did not have to provide a comprehensive set of services but only a limited service required by and sufficiently to a large extent for the villagers. Such limited operations in the Rural Banks limited their operational costs too. In villages where branches of commercial banks could not exist most of the Rural Banks were operated viably due to their low operational costs. The functions of a Rural Bank were mostly confined to the limited area of operation of its Cooperative Society and the officers of the bank were also most probably from the same area. This local staff had a fair knowledge of conditions of the area as well as of their clientele and therefore they could use that knowledge to assess the borrower's credit needs, as well as credit worthiness in making credit decisions. With this close knowledge the Rural Banks could relax borrower's securities in their credit business; that is granting loans on personal guarantees rather than demanding fixed assets as securities. This was a great advantage the Rural Banks had in the field of rural credit, since most of the fixed assets available with the villagers were inherited undivided lands which did not qualify enough as securities for loans in commercial banks.

On the other hand, the local staff of the Rural Banks who were housed in the Co-operative buildings found it easier to help the villagers to get more familiar with the new institution, than staff in the branches of conventional types of commercial banks which was almost foreign to the villagers at that time. The less educated and less sophisticated village farmers preferred the Rural Banks where they could obtain limited, but necessary banking facilities without having to face more elaborate banking procedures and many formalities. Being a less bureaucratic banking institution the Rural Bank was in a better position to maintain a close relationship with its village clientele. Operational time of the bank which was convenient to the clientele became an advantage for both parties. The pawn broking system operated by the Rural Banks was a traditional lending system which the village people were familiar with. Linkage of banking with marketing and sales in the MPCSs enabled the village producer to obtain timely credit and also easily; while they were encouraged to save part of the income from their production in the Rural Bank. Since the Rural Banking system was operated through the Co-operatives an organization which had wide geogeographical coverage throughout the country the new banking system was capable of reaching a large majority of both producers and consumers in the rural sector. According to the nature of the rural economy – the large majority of income earners in this sector were paddy farmers, with small plots of land and high seasonal variations of income. They received their income at the time of the harvesting seasons, most probably twice a year, while both their production and consumption expenditures had to be incurred throughout the year. During the harvesting seasons their surplus income was absorbed by the Rural Banks by way of deposit mobilization, and these resources were transferred to the other areas for investment in other economic activities. During the off seasons when the village farmer needed money, the Rural Banks obtained resources from the other sectors of the economy and disbursed them among the villagers. If the Rural Banks were taken individually in their respective areas, in general some banks were beyond the level of self-sufficiency in funds while others were below that level. The excess funds of the banks which were beyond the level of self-sufficiency were transferred to the banks which needed the resource support. In addition to these resources if the Rural Banking system is taken as a whole, in the early years of the initial phase of the scheme this system faced the problem of deficit funds. These funds were provided from the out side sectors to be employed in development activities in the rural sector. All types of such transmission of funds within the Rural Banks and between the Rural Banks and the other sectors were smoothly carried on through the network of the branches of the People's Bank.

The Rural Banking Scheme was a device formulated to enjoy both the benefits of unit banking like use of local knowledge in lending, low cost operation, ability of reaching a rural clientele; and branch banking in various types of assistance extended by the People's Bank.

Performance During Initial Period

The Co-operative Rural Banking Scheme was launched with the opening of the first Rural Bank, named the "Menikhinna Rural Co-operative Bank", on March 26, 1964. This was a Branch of the Co-operative Society at Manikhinna in the Kandy district. Another two Rural Banks were started in April and May in the same year, and during the next two years of 1965 and 1966 the Scheme was extended by setting up of 5 banks in each of these years. With the initial experience that the Scheme was running satisfactorily the expansion rate was increased. From the end of 1966 to the end of 1971 the number of banks were increased to 111 at the average rate of 20 banks per year. Though the expansion of Rural Banks from 1966 to 1971 showed a steady growth, this growth was comparatively slow if we consider the period after 1971. This was because during the initial period of the Rural Bank Scheme, banks were set up on a experimental basis only in selected Co-operative Societies.

The number of savings account holders in the Rural Banks increased to only 4,600 upto the end of 1966 but thereafter it increased rapidly to 60,400 by the end of 1971. There was a sudden increase in the number of savings account holders, going up from 28,600 at the end of 1969 to 49,900 at the end of 1970. Of this increase 54 percent occurred during the last quarter of 1970 due to the demonetisation of the currency within this period. Following a similar trend saving deposits too increased from Rs.703,000 at the end of 1966 to Rs.17,188,000 at the end of 1971. During the fourth quarter of 1970 savings deposits nearly doubled from Rs.8,255,000 to Rs.16,109,000; due to both an increase in the number of savings accounts and also the average amount of deposits in savings accounts increasing as a result of the demonetisation. At the end of 1971 savings deposits had increased very marginally because a good part of the funds deposited during the demonetisation period was withdrawn during the early months of 1971. The Rural Banks had a limited number of fixed deposit accounts but a higher average amount of deposits compared with its savings accounts. During the later years of the initial period of the Rural Bank Scheme more people opened fixed deposit accounts even if the deposits were small. For example in 1967 there were only 41 Fixed Deposit accounts with an average deposit of Rs.1,595 whereas in 1971 there were 838 of these accounts with an average deposit of Rs.807.

The number of loans and total amount of loans granted by the Rural Banks which stood at 2,897 and Rs.2,029,000 at the end of 1967 increased rapidly to 10,017 and Rs.7,122,000 by the end of 1970. However, the increases in both these figures were very marginal in 1971 since a good part of the money withdrawn from savings accounts early in 1971 may have been used to fulfill their credit requirements, and therefore there was limited need to take more loans and advances. The number of advances and total amount of advances made on pawn broking also followed a similar trend over this initial period. The average size of an advance made on pawn broking ranged from Rs. 96 in 1967 to Rs.114 in 1968, and was smaller than that of a loan which ranged from Rs. 650 in 1968 to Rs.793 in 1965. Contrarary to the period after 1972, during the period before this the total amount of advances made on pawn broking were much lower than the total amount of loans granted. When the total loans excluding advances on pawn broking were analysed, according to purpose, similar to the period after 1971 the highest share had been granted for housing purposes and it was increasing during this period, while the next highest share was for agricultural purposes and these were on the decrease The share of housing loans had increased from 23.4 percent in 1964 to 36.2 percent in 1971; while those for agriculture had decreased from 36.5 percent in 1964 to 18.8 percent in 1971. When the operation of the Rural Bank scheme was examined as a whole, during its first six years we observe that it had given more credit (including advances made on pawn broking) than the deposits it had mobilized. However, before the end of this initial period it was able to become self-sufficient in funds with its deposits exceeding credit in the second part of 1970.

During the seven year initial period the experimental phase of the Scheme - it appeared to be a viable scheme which could achieve the objectives for which it was set up. Though during this perid the scheme was confined only to limited functions and limited areas in the rural sector it was able to mobilize a substantial amount of rural savings and, by reaching a level of self sufficiency to use those local resources for investment in the rural sector. Many villagers who used to deal with the informal sector, in regard to their savings and also their credit requirements were now also looking to the banking sector. This was a very positive aspect of the Scheme, as it succeeded in introducing the banking habit to wide sections in the villages by the end of its initial period. The experiences and achievements gained in the experimental phase of the scheme led to a rapid expansion in the scheme in terms of numbers of branches, area of coverage, volume and types of functions; in addition to re-designation of the name of the bank as the "Co-operative Rural Bank", consequent to the reorganisation of MPCSs in 1972.

THE ROLE OF CO-OPERATIVE RURAL BANKS IN SRI LANKA'S RURAL SECTOR

M.W. Panditha

An amended version of a paper originally presented by People's Bank's General Manager M.W. Panditha at the Senior Executive Group Study/Observations Programme 1984 of the Asian Pacific Region Agriculture Credit Association held in Colombo. Mr. Panditha has been closely associated with the Bank's Rural Credit Department from its inception and also with the pioneering of the Rural Banks Scheme.

Rural Banks or Co-operative Rural Banks (CRBs) as they were subsequently renamed (1) celebrate the 25th anniversary of their establishment in March this year. This banking system was launched by the People's Bank during its formative stages as an institutional device through which the Bank could supplement its programme for provision of banking facilities to the rural sector through the Co-operative Movement. A CRB is not a Bank in the conventional sense but, it is the financial arm of a Multi-Purpose Co-operative Society. It is not a separate legal entity and does all its business in the name of the Multi-Purpose Co-operative Society of which it is a part. At present, there are 282 CRBs and 685 CRB branches covering the entire island.

In this paper, an attempt would be made to describe the objectives and functions of these institutions, the rationale for their setting up and their role in rural credit.

BACKGROUND

The concept of combining credit, marketing, resource mobilization and other general purpose activities at village level in one single organisation is not new to the Co-operative Movement. Raiffeisen, the father of the Credit Society himself appears to have harboured similar views. (2)

In Sri Lanka too, in 1957 when the proposal for re-organisation of the Co-operative Movement was adopted and the single purpose Co-operative Societies were amalgamated into Multi-purpose Co-operative Societies, the inclusion of banking as one of the functions of these Societies was accepted as essential for the dynamic role they were expected to play in the development of the rural economy.

The Committee which recommended the formation of Multi-purpose Co-operative Societies in 1957 inter alia made the following observations:

> "It should be noted that all Multi-purpose Co-operative Societies will be primary Rural Banks and their relation with District Bank or Co-operative Development Bank (3) are matters for settlement after discussion with the latter Bank."

I shall now outline briefly some facts of the rural setting as it existed before establishment of the People's Bank, as a backdrop to the understanding of the role of CRBs.

Of the 4.5 million acres of agricultural land, about 2.3 million acres were cultivated with tree crops, mainly tea, rubber and coconut which form the principal agricultural exports. These crops are grown mostly on commercial lines. On the other hand, the agriculture of the small farmer is primarily paddy cultivation. The size of holdings in this sector is small, and are uneconomic at the lower end. The number of holdings stood at 1,189,801 of which paddy holdings accounted for 49 percent. An average holding being 1.9 acres the farm sizes differed widely. (4) Natural hazards pose a constant threat.

Approximately 72 percent of the population live in village areas and are engaged mostly in agriculture. Since agricultural incomes are seasonal and subject to wide variations, specially among small farmers, there is a constant need for credit in the rural sector both for purposes of production and consumption.

Besides, the tenurial reforms which were introduced in the mid 50's warranted the establishment of institutions to finance tenants who were hitherto assisted by the land owners.

The re-organisation of the large number of single purpose Co-operatives into Multi-purpose Co-operative Societies was considered to be the answer to many of these problems. It was expected to be "the Village Bank, the Village Stores Society, the Marketing Society and the Labour Society, all rolled into one." The establishment of an islandwide network of Multi-purpose Co-operative Societies was therefore undertaken in 1957.

The People's Bank

Provision of funds for this vast network required the establishment of a powerful Co-operative apex Bank. This Bank was established in 1961 as a Commercial Bank under the name of People's Bank. The original purposes of the Bank were to develop the Co-operative Movement, rural banking and agricultural credit.

After the establishment of the People's Bank, provision of financial assistance to the Co-operative Movement increased in quantity to a marked degree. But this increase represented merely an expansion of the already existing services which were provided by the Co-operative Banks rather than a new departure to develop rural credit on the lines envisaged in the Bank Act. During the initial stages the Bank established a large number of branches, specially in areas

(1) *In 1972, with the amalgamation of Multi-Purpose Co-operative Societies into large Primary Societies, Rural Banks were re-named Co-operative Rural Banks.*

(2) *"The object of the society is to improve the situation of its members, both materially and morally, to take necessary steps for some to obtain through the common guarantee the necessary captical for granting loans to members for the development of their business and other household needs, to bring idle capital into productive use for which purpose a Savings Bank will be attached to the Society."*

(3) *The Co-operative Development Bank referred to above however did not see the light of day, but in its place was established in 1961, the People's Bank with almost identical objectives.*

(4) *Census of Agriculture 1983.*

which had not been hitherto served by commercial Banks. It also opened the doors to the people in lower income groups who could not obtain facilities from other commercial banks. But these facilities were provided mostly to fixed income earners in lower income levels.(5)

In contrast to the Bank's success in assisting such small fixed earners, was its inability to make a worthwhile impact in the sphere of agricultural credit in the rural sector. Access to credit, absence of bankable securities, irregular pattern of income and other inherent defects in rural agriculture inhibited to a large extent the Bank's ability to expand its role in the rural sector. Besides, the inadequacy of the normal canons of commercial lending in assessing credit-worthiness of rural cultivators and the magnitude of the problem itself precluded the Bank from finding an effective solution to this problem on its own.

Short-term crop loans were however not provided as there was a scheme already in operation by the Government.

A review of the performance of this scheme by the Bank in early 1964 surfaced several weak aspects which are described below and formed the basis for an improved system. (6)

(a) The managerial capabilities of the staff had to be strengthened by providing external support and training.
(b) In providing credit, pre-sanction and post-sanction evaluations of applications should be done in a methodical way.
(c) Methods will have to be evolved (i) to accept securities available at village level such as lands without clear title (ii) to recognize the credit standing of borrowers who could not provide documentary evidence of their worth.
(d) There is a need for delegation of authority of the Boards of Societies to sub-committees and Credit Managers to enable quick decision making in disbursing credit.
(e) The procedures relating to (i) proper custody of documents; (ii) maintenance of up-to-date Book-keeping records; (iii) security arrangements and (iv) loan documentation, should be strengthened.
(f) This scheme as it was constituted, was inadequate both in terms of its scope and its operations to meet the rural credit requirements and to act as a catalyst in promoting the rural sector.
(g) The provision of a credit line and supporting services in themselves were inadequate to restore the confidence of the rural community who had witnessed for nearly half a century the disbursement of credit by Co-operatives. The Credit Depatment of Co-operatives had to be given the image of a Bank.
(h) The Societies' lending should be linked to Bank lending.

Setting up of Rural Banks

The lessons drawn from this experiment and the agonizing re-appraisals of its own limited role in the rural sector, led the People's Bank in 1964 to develop the concept of banking through Co-operatives into a practical and working proposition. The result was the formulation of the Rural Banking Scheme.

The objectives of setting up Rural Banks were then enunciated as follows:

i) To provide credit facilities in a fruitful manner to members of societies.

ii) To provide credit supervision for facilities granted.

iii) To up-grade the book-keeping and documentation system.

iv) To develop methods for savings mobilization.

To ensure their viability, the new scheme was thrown open to those MPCSs which conformed to the eligibility criteria prescribed. (7) Priority was given to societies operating the Extended Scheme successfully.

Eligible Societies could make their applications to the Bank to join the scheme. Thereafter the Bank did the selection on a case by case basis after an inspection and scrutiny of the Society. Once selected, the Society and the Bank entered into an Agreement setting out the terms and conditions under which the Rural Bank was to operate.

As an initial step for the establishment of Rural Banks, the selected Societies were expected to amend their By-laws to enable them to establish Rural Banks. The People's Bank in turn provided the following: (a) financial assistance for on-lending; (b) managerial assistance by seconding one of its own employees; (c) safes, counters, stationery and equipment for pawning; (d) supervision.

Under this scheme, credit facilities were made available to members for production, housing, debt redemption, trade, consumption, emergencies and for rural electrification. These facilities were provided both as short-term and medium-term loans with repayments ranging from 1 year to 5 years.

These Rural Banks were authorized to engage in pawning as agents of the People's Bank.

Crop loan facilities of a seasonal nature however were not introduced as a scheme of granting cultivation loans, implemented by the Government, was in operation. However, provision of temporary Bridging finance facilities was envisaged against such loans.

Facilities were made available both for members and non-members to maintain different types of savings accounts such as, ordinary savings accounts, minor's savings account and Investment Savings Accounts. Members were expected to enter into a Marketing Agreement with the Society. All sales proceeds were expected to be credited to their accounts. Fixed Deposits were also accepted from members and non-members. Current Account facilities too were provided to members of the first three Rural Banks at the initial stage after which this facility had to be hastily withdrawn when certain legal impediments were encount-

(5) Facilities were granted for the following purposes initially Production (Rs.2,500/-); Consumption (Rs.500/-); House Repairs (Rs.2,500/-); Redemption on Debts (Rs.2,500/-); with a maximum of Rs.3,000/- per member and was extended later.

(6) This scheme continued till 1979 side by side with the Rural Bank Scheme.

(7) (i) Minimum membership of 500; (ii) Shares of at least 75 percent members should be upto date; (iii) There should be no default by any creditor; (iv) Society is run at a profit; (v) Should be atleast 3 years after establishment; (vi) Should be an agent for paddy purchases; (vii) Should have a strong building.

ed. Had these current accounts been maintained, more innovative credit facilities would have been evolved.

By 1971 this scheme had been extended to 111 Societies and the number of accounts attracted had grown to 60871. By this time this institution had not only gained the confidence of the rural population, but had also attracted the attention of academicians, researchers and officialdom as a new banking concept worth taking seriously. The establishment of banking sections in all amalgamated MPCSs was accepted as Government policy.

Changes in Rural Banks after Amalgamation of MPCSs

The amalgamation of a multitude of small MPCSs to a relatively small number of large MPCSs covering a wider area of operation, necessitated in 1973 certain organisational changes in the structure of Rural Banks. These Banks which were hitherto run on unitary lines, became a branch banking system with Head Office operations and Branch operations. Most of the former Rural Banks became branches of the new Banks. The name Rural Bank too was changed to Co-operative Rural Bank. A new cadre of Co-operative employees designated "Marketing and Credit Manager" (8) was placed in charge of these Banks. Accounting and maintenance of records were centralized. The role of the People's Bank became more supervisory. This change, brought in its wake a weakening of the People's Bank's control over these institutions.

In 1973, to cope with the newly introduced expanded crop loan scheme, functions of CRBs were re-defined and widened as follows – (a) Mobilization of deposits from members. (b) Provision of loan facilities to members for production and consumption purposes attuned to MPCS development programmes. (c) Pawn broking facilities for members and non-members. (d) Provision of money, payments and transfer services. The provision of crop loans was also brought within the ambit of CRBs. The Co-operatives however lost their monopoly over cultivation credit as the Bank of Ceylon too joined the scheme in 1973. The concept of considering the farmer as a unit of production and assessing all his credit needs within a comprehensive plan under which a credit limit was to be approved for each farmer was introduced and was called the Comprehensive Credit Scheme.

Although different types of credit requirements came under a single credit limit refinance from the Central Bank was available only for crop loans. Therefore, different lending schemes came to be maintained separately.

Lending Schemes

Thus, three main lending schemes came to be operated – (1) Short and Medium term facilities provided under the Comprehensive Credit Scheme and the original Rural Banking Scheme. (2) Seasonal crop loan facilities for paddy and other subsidiary food crops provided under the Comprehensive Credit Scheme. (3) Pawning as People's Bank's agents.

Short and Medium Term Lending

Purposes for which these credit facilities are provided and their terms are given in Table 1. This also shows the gradual increase in limits under each purpose. The current rates of lending to Societies for CRB funding is 15 percent p.a. CRBs re-lend to members retaining a margin of about 4 – 5 percent. The People's Bank does not specify the on-lending rate. Loans upto Rs.5,000/- could be obtained against the guarantee of two acceptable members, and for those above this limited collateral security is taken. There is provision even to accept lands with undivided ownership as security. Village notaries attend to little investigations and mortgages. Loans against 90 percent of fixed and savings balances are also provided. Within the prescribed ceilings, funds are provided for the full cost of a project,

TABLE 1
CRB CREDIT FACILITIES

Purpose	Maximum Amount					Maximum Repayment Period
	1964	1968	1973	1980	1985	
1. Production	2,500	5,000	7,500	15,000	35,000	1-5 years
2. Housing	2,500	5,000	7,500	15,000	35,000	3-5 years
3. Debt Redemption	2,500	5,000	5,000	5,000	5,000	5 years
4. Trade	–	–	1,000	2,000	5,000	–
5. Consumption (Purchase of consumer durables like radios, sewing machines)	500	500	1,000	5,000	7,500	1 year
6. Emergencies	200	200	200	500	1,000	1 year
7. Electrification	–	600	1,000	3,000	3,000	5 years
Maximum loan limit per individual member.	3,000	5,000	7,500	15,000	35,000	

TABLE 11
TOTAL CRB ADVANCES

	No. of Accounts	Balances (Rs.)
1. Agricultural Production- Sub total	19,647	57,645,634
2. Consumption	4,871	9,966,801
3. Industries	5,643	20,660,585
4. Housing	44,537	211,999,345
5. Redemption of Debts	7,785	20,144,976
6. Trade	5,040	15,881,824
7. Animal Husbandary	4,801	15,811,695
8. Electrification	1,611	4,384,680
9. Others	5,941	17,267,356
TOTAL	99,876	373,762,896.

(8) They are now called Banking Service Managers.

TABLE III

GOVERNMENT SPONSORED CROP LOANS THROUGH CO-OPERATIVE RURAL BANKS AS AT 30-06-1988

Year	Amount Utilized Rs.	Total Repayment Rs.	Amount Outstanding Rs.	% of Recovery
1973	38,381	26,872	11,509	70.0
1974	134,605	76,703	57,902	56.9
1975	97,087	52,293	44,794	53.8
1976	67,491	41,406	26,085	61.3
1977	89,273	43,828	45,445	49.0
1978	371,495	102,051	269,444	27.4
1979	25,995	23,767	2,228	91.4
1980	23,960	21,964	1,996	91.6
1981	28,150	25,639	2,511	91.0
1982	24,096	20,959	3,137	86.9
1983	28,740	26,861	1,879	93.4
1984	23,955	21,842	2,113	91.1
1985	14,829	12,765	2,064	86.0
1986	27,677	23,806	3,871	86.0
1987	37,240	27,898	9,342	74.9
1988*	16,927	7,322	9,605	43.2
TOTAL	1,049,901	555,976	493,925	52.9

*1988 –as at 30.09.88.

without calling for an enquity contribution. (9)

As at 30.06.1988, Medium and Short-term loans outstanding was Rs.373.7 million in respect of 67,364 loans. A purpose-wise breakdown of these facilities are given in Table 11.

A regional-wise analysis indicates that 92 percent of the loan volume has been disbursed outside Colombo District thereby demonstrating the strong rural biased dispersion in lending.

Lending operations and credit disbursements have not been upto expectations. Apart from the minimum share requirements for borrowings, relatively high interest rates, internal administrative problems, the lack of emphasis on identification and appraisal of small scale rural projects too appear to contribute to this position.

(9) This is however counter-balanced by the share contribution requirement up to 10% of a loan.

(10) At present these scales vary from Rs.1,875/- to Rs.2,625/- per acre of paddy.

Crop Loans

Since 1973, the provision of seasonal crop loans too were brought within the CRB Scheme. Credit facilities are provided for paddy and sixteen Subsidiary Food Crops; for purposes such as land preparation, seed, fertilizer, agro-chemicals and for harvesting. The scales of finance per acre are periodically decided by the Ministry of Agriculture in consultation with the Banks. (10) Under this scheme the Central Bank provides 100% refinance facilities and the People's Bank lends these funds to MPCSs which, in turn relend to member farmers through the CRBs. The performance of this scheme is summarised in Table 111.

Since a fuller discussion of this scheme is being made in other papers, suffice it to add here that Proposals for major changes to expand the coverage of this lending scheme have been made by Bank to the Central Bank, under which due recognition has been given for the setting up of an inbuilt mechanism for re-scheduling of loans by way of a Stabilization Fund to cover loan defaults due to natural hazards, a problem which had bedevilled many a lending scheme in the past.

Pawning

Loan Facilities granted against pledge of jewellery can be considered as the most successful lending operation of the CRBs. Societies could engage in pawning either with their own funds or after obtaining overdraft facilities from the People's Bank. Pawning loans are given both for essential purposes and consumer purposes to non-members and members. These advances are repayable within a year. Renewal of advances are however allowed after payment of the annual interest. The Bank lends funds for these purposes currently at 23 percent p.a. and the CRBs in turn relend at 28%- 30% p.a. As at 30.06.88, pawning advances stood at Rs368.5 million in respect of 391,153 advances.

Savings Mobilization

CRBs have proved to be a very effective medium of mobilizing rural savings. Both the volume of savings and the number of savers bear witness to this phenomenon. As at 30.06.88, Savings and Fixed Deposit balances outstanding were Rs.1,750 Mn. Of this Rs.1,556 Mn were held in 2,273,358 savings accounts.

The deposits and advances position under the CRB scheme as at 30.06.1988 could be summarised as follows: –

	Volume (Rs. Mn)	No. of Accounts
Advances		
1) Short and Medium-term Loans	373.7	99,876
2) Pawning	368.5	391,153
3) Crop Loans Scheme since 1988 Yala	583.7	–
	1,325.9	
Deposits		
Savings	1,556.7	2,273,358
Fixed Deposits	194.0	25,165
	1,750.7	

Another noteworthy feature of savings mobilization is that 63 percent of savings deposits and 59 percent of savings accounts were held by non-members, which demonstrates the extent of confidence reposed by the rural community in CRBs.

Although the gross loans/deposits ratio indicates a lending surplus, when cultivation loans for which Central Bank refinance is available, to the People's Bank are set aside, the advances/deposits ratio is only 42 percent.

Much has been said about the short-fall of lending vis-a-vis, the deposits mobilized. One cannot overlook the fact that the bulk of savers being non-members are ineligible for loans except pawning advances. Viewed in this light the position does not look so unfavourable

Investment of Surplus Funds

The People's Bank provides facilities for Rural Banks to invest their surpluses in the form of Fixed and Savings Accounts. Surpluses built in current accounts are periodically transferred to Savings Accounts maintaining only minimum balances required in current accounts. In addition CRBs too invest their surpluses in the National Savings Bank when their rates are more favourable. Besides, the healthy savings supluses position has enabled a large number of societies to satisfy the demand for credit from their members with their own resources. Latest figures indicate that, of the 967 Rural Banks 617 are managing with their own funds.

Profile of a Co-operative Rural Bank

The Board of Directors of a MPCS holds the overall responsibility of the CRB through the General Manager who is assisted by an Executive Grade Officer designated as "The Banking Services Manager", whose sole function is the management of banking activities. Generaly, a CRB will have 2-3 branches. These branches are under the control of Branch Managers. A typical CRB branch will be a small unit consisting of a Branch Manager and assisted by one or two clerks. There will be about 75 - 100 transactions a day covering savings accounts, pawning and other lending operations. Monthly about 10 loan applications would be handled during off seasons and a heavier work load during the cultivation season. The processing time of loan applications would vary from 1 - 6 weeks, depending on the nature of securities and the purpose.

Applications for credit by members are entertained at a Branch of the CRB or Society. These are examined by the Branch Manager and the Branch Committee of elected members and are referred to the Banking Services Manager at the Head Office of the society. Processing of applications are generally handled at the Head Office and are referred to the Sub-committee of the Board of Directors where the General Manager, People's Bank representative and a few members of the Board participate, in making recommendations to the Board of Directors. These applications are thereafter submitted to the Board of Directors for approval. The Banking Services Manager is delegated with authority to grant loans for emergencies, and he thereafter seeks the covering sanction of the Board of Directors.

Banks are open for business generally from about 9.00 - 1.30 p.m. but in certain areas hours are extended upto about 3.30 p.m. Most CRBs are open for business on Saturdays as well.

Overall Profitability

It may also be of interest to examine the overall profitability of Rural Banks. The main source of income of Rural Banks is the interest received from pawning advances. Their administrative costs are fairly low as these units are managed by a small staff. As at 30.06. 1988 of the 967 Rural Banks 597 are reported to be running at a profit. Their total profits were Rs.31.4 Mn and the total loss of the balance 370 were Rs. 784,731/-. Thus, the CRBs have become one of the main profit centres of MPCSs.

Financial Safeguards

Certain safeguards have also been introduced to strengthen the financial viability of lending operations and safety of deposits. Under these arrangements (1) MPCSs are expected to make an annual assessment of the delinquent loans and set apart a portion of their annual profits to a "Reserve for Bad and Doubtful Debts." (2) All CRBs are also required to deposit monthly to a special Savings account at the People's Bank styled "Rural Bank Deposit Guarantee Fund." An amount equivalent to one-tenth of 1 percent of the total monthly deposits made by depositors to Fixed and Savings Accounts maintained with them and (3) A contingency Fund for pawning has been set up to which the CRBs contribute monthly a portion of the interest received, and is meant to recoup losses which are not covered by insurance.

Supervisory and Review Mechanisms

Operations of these institutions are reviewed periodically by several institutions. In addition to the internal audit conducted by the Society itself the Development Assistants of the People's Bank are also expected to audit all vouchers and transactions handled daily by CRBs. These audits are conducted normally during weekly visits. They are also subject to the annual Co-operative Department's Audit. The Regional Offices of the People's Bank carry out annual inspections and quarterly surprise checks to review lending operations and other activities. As at 30.6.88, 161 of the 967 CRBs had been inspected by Regional Offices during the year. In addition, the Rural Credit Department of the Central Bank of Ceylon also inspects the Rural Banks which are selected at random.

Conclusion

Now that the CRBs have come of age and have demonstrated their capabilities to undertake wider responsibilities, some of the lines on which further expansion could be examined are: –

a) introduction of Current Accounts, enabling provision of facilities through these Accounts, as Overdraft facilities revolving credit facilities etc., for which amendments to existing law would be necessary;

b) delegation of authority to CRBs to act as the People's Bank's agents and accept and transmit to the People's Bank, applications for larger facilities from members and non members;

c) assisting these societies to finance self employment programmes and the People's Bank's Small Scale projects financing that would help to reduce poverty in rural areas;

d) Upgrading customer services by introduction of automation. A beginning has been made at the Manikhena Co-operative Rural Bank.

The People's Bank is presently examining the feasibility of expanding their services on these lines.

RURAL BANKS – BY DISTRICT, URBAN -RURAL, DEPOSITS, ADVANCES AND INVESTMENT – AT END OF 1988

CLASSIFICATION	DISTRICT	NO. OF SOCITIES	NO. OF RURAL BANKS	TOTAL DEPOSITS	TOTAL ADVANCES	PAWNING ADVANCES	INVESTMENT IN P/BANK	OTHER BANKS	TOTAL INVESTMENT
	Colombo	10	63	189.6	96.0	63.3	68.7	34.8	103.5
URBAN		10	63	189.6	96.0	63.3	68.7	34.8	103.5
% Total			6.4						
	Kalutara	10	47	72.1	23.8	16.3	21.1	26.1	47.2
	Galle	18	72	165.7	60.6	27.2	46.0	49.7	95.7
	Gampaha	17	110	298.6	109.4	83.4	76.6	148.5	225.1
	Kandy	22	73	167.9	77.0	40.7	68.1	6.6	74.7
	Jaffna	22	28	54.7	1.7		52.0	5.4	57.4
SEMI URBAN		89	330	759.0	272.5	167.6	263.8	236.3	500.1
% Total			33.7						
	Kegalle	10	51	75.7	37.9	14.9	34.2	4.2	38.4
	Badulla	12	47	59.4	23.2	17.2	21.7	-	21.7
	Ratnapura	13	58	154.0	22.8	16.2	61.5	52.3	113.8
	Matale	10	17	26.6	17.1	8.8	9.6	1.0	10.6
	Matara	8	64	145.5	35.5	16.5	13.6	71.4	85.0
	N'Eliya	9	26	37.9	19.2	9.0	16.3	2.4	18.7
	Kurunegala	18	119	201.7	58.9	9.7	54.6	109.6	164.2
	A'pura	21	30	13.6	5.4	4.0	4.1	-	4.1
	Polonnaruwa	9	25	31.2	29.2	6.7	13.2	-	13.2
	Trincomalee	7	12	0.1	0.4	0.4	0.1	-	0.1
URBAN/RURAL MIX		117	449	745.8	249.6	103.4	228.9	240.9	469.8
% Total			45.9						
	Moneragala	6	13	11.0	0.5	0.1	6.3	-	6.3
	Hambantota	7	32	41.7	17.0	7.2	19.4	8.8	28.2
	Puttalam	8	38	51.3	19.2	8.3	9.5	22.3	31.8
	Batticaloa	13	12	4.0	3.1	2.9	2.3	-	2.3
	Ampara	15	22	6.8	8.2	5.7	0.8	-	0.8
	Vavuniya	3	3	-	-	-	-	-	-
	Mannar	6	6	0.3	-	-	0.7	-	0.7
	Kilinochchi	4	4	2.8	-	-	2.4	-	2.4
	Mullativu	5	5	-	-	-	-	-	-
RURAL		67	135	118.0	48.0	24.2	41.4	31.1	72.5
% Total			13.8						
SRI LANKA		283	977	1,812.4	666.1	358.5	602.8	543.1	1,145.9
% Total			100.0						

CLASSIFICATION	NO.OF SOCIETIES	NO.OF RURAL BANKS	TOTAL DEPOSITS	% DEPOSITS	TOTAL ADVANCES	% ADVANCES	TOTAL INVESTMENT	% INVST.	INVESTMENT AS A % OF TOTAL DEPOSITS
URBAN	10	63	189.6	10.5	96.0	14.4	103.5	9.0	54.6
SEMI URBAN	89	330	759.0	41.9	272.5	40.9	500.1	43.6	65.9
URBAN/RURAL MIX	117	449	745.8	41.1	249.6	37.5	469.8	41.0	63.0
RURAL	67	135	118.0	6.5	48.0	7.2	72.5	6.3	61.4
SRI LANKA	283	977	1,812.4	100.0	666.1	100.0	1,145.9	100.0	

CO-OPERATIVE RURAL BANKS – A SUCCESS STORY?

Nimal Sanderatne

Dr. Nimal Sanderatne has developed his interest in the rural financial and agricultural sectors over nearly three decades. He has written authoritatively on these areas and some of his specialised writings have appeared in the Economic Review, from as far back as April 1975. He was a former Director of Economic Research, Central Bank and is at present Chairman, Bank of Ceylon.

Twenty five years ago the People's Bank launched a new institutional means for improving financial intermediation in rural society – the Co-operative Rural Banks. The rationale for establishing these Co-operative Rural Banks lies in both the nature of the rural economy and the difficulties of establishing viable branches of commercial banks in rural areas. A Co-operative Rural Bank is also a more suited institution for rural society owing to its limited area of operation, its less imposing edifice and its already established relationship with, and intimate knowledge of, customers through the co-operative.

The importance of establishing institutions to mobilise savings was expressed very clearly a few years before the establishment of rural banks by Professor Edward Nevin:

"The tasks of financial institutions in an underdeveloped territory are therefore almost self-evident. In the first place, their purpose is to provide a collecting point for savings of a relatively small average amount from a large number of individual sources. So long as the means to utilize savings safely and profitably are not available within an economy, funds will either be diverted abroad, sterilised in useless hoards of cash or precious metals, or, more likely still, will not accumulate at all. However, poor an economy may be there will be a need for institutions which allow for such savings as are currently forthcoming to be invested conveniently and safely, and which ensure that they are channelled into the most useful purposes. The poorer a country is, in fact, the greater is the need for agencies to collect and invest the savings of the broad mass of persons and institutions within its borders." [1]

Rural banks were expected to serve this objective, Nevin discussed above as well as be a means of providing finances for the needs of rural borrowers. A fulfillment of the latter objective would imply a reduced role for informal lenders, particularly money lenders who charge very high rates of interest, an increase in the supply of credit and better conditions of borrowing. The establishment of rural banks in 1964 could be considered an important step in expanding the institutional means of mobilising savings, expanding credit in the country and providing some of the services of commercial banks to remote areas which would not have had such facilities otherwise.

Factors Favouring Rural Banks

Rural banks were therefore envisaged as a means of extending even limited banking and credit facilities to areas whose conditions do not justify the extension of the branch banking system. It was also considered a means of combining the advantages of a unit banking system, such as personalised knowledge of the clientele and local conditions, with the advantages of a branch banking system, which enables the transfer of resources between difficult areas and a greater security and stability of funds.

From the point of view of a commercial bank a rural bank is much less costly to operate than a branch of a commercial bank. The costs of operating a branch bank being high, the limited operations in a rural bank area necessitates the provision of banking facilities at lower costs for making the unit financially viable. On the criterion of financial viability most rural bank areas would not have been served with any commercial bank branches. In contrast to a commercial bank branch a rural bank is often housed in the co-operative society building and engages persons on its staff who are paid lower salaries than regular People's Bank staff members. The choice in these areas is between limited banking facilities as provided by rural banks or no facilities at all.

From the point of view of the rural clientele the provision of even limited banking facilities by a local and familiar institution may be preferable to a more imposing but less comprehensible type of institution. In fact most rural people could be intimidated by conventional bank branches and consequently would not have a capability to mobilize the savings of most rural people. They may dole out some finance to farmers under special agricultural credit programmes, but they will not really have a rural clientele who have confidence in their bank. The personal acquaintance of rural bank personnel and the operation of the bank at times convenient to the clientele are advantages of particular significance in the rural context of limited familiarity with institutional savings and credit organizations.

The introduction of even a rudimentary form of banking was considered a useful educative experience to a rural bank's clientele, who would gain a familiarity with banking procedures. The development of banking habits, particularly of depositing excess cash holdings and the responsible management of an account, was expected to create a responsible clientele to whom fuller banking services may be extended. Further, the operations of a rural bank would provide a basis on which it could be decided whether fuller banking services should be extended in the area either by the extension of the branch banking network or the expansion of the rural bank's activities.

During the initial experimental phase rural banks were set up only in co-operative societies, which had functioned for a minimum of three years, had a strong membership which had paid their share capital regularly; a good loan repayment record and running at a profit. Most co-operative societies selected to run rural banks had implemented the People's Bank's Extended Credit Scheme.

At the end of 1966 only 13 rural banks had been established but they increased to 111 at the end of December, 1971. After 1972 the number of rural banks increased rapidly due to the reorganisation of Multi-purpose Co-operative Societies, and the government decision to attach a rural bank to each of the reorganised Multi-Purpose Co-operative Societies. It was after 1972 that rural banks came to be named "Co-operative Rural Banks". During 1972 alone 131 new rural banks were established and 111 of them were set up in the first quarter of the year. In order to implement the government decision to channel loans under the Comprehensive Rural Credit Scheme through rural

1. Edward Nevin, Capital Funds in Under-developed Countries, the Role of Financial Institutions, London 1961.

banks, the number of rural banks was increased from 242 at the end of December 1972, to 341 within the next year.

The number of Co-operative Rural Banks declined to 332 at the end of 1974 due to the amalgamation of some as a result of the reorganization of Multi-Purpose Co-operative Societies. Yet in the same year, special branches of the Co-operative Rural Banks were opened in the 'pradeshikas' of the Multi-purpose Co-operative resulting in a further expansion of the rural banking network. These special branches perform the same functions as Co-operative Rural Banks.

TABLE 1

EXPANSION OF CO-OPERATIVE RURAL BANKS – 1964 - 1988

Year (as at end December)	No. of Co-operative Rural Banks	No. of Special Branches	Total
1964	3		3
1965	8		8
1966	13		13
1967	27		27
1968	44		44
1969	68		68
1970	70		70
1971	111		111
1972	242		242
1973	341		341
1974	332	71	403
1975	338	109	447
1976	345	158	503
1977	285	259	544
1978	284	275	559
1979	284	302	586
1980	284	357	641
1981	287	459	746
1982	286	518	804
1983	288	555	843
1984	286	602	888
1985	286	628	914
1986	283	649	932
1987	282	673	955
1988	282	686	968

The progressive expansion of Co-operative Rural Banks during the 25 year period may be assessed from Table 1. The network of Co-operative Rural Banks expanded quite rapidly, particularly after 1972. The number of rural banks increased to 332 at the end of the first decade in 1974, to 888 at the end of the second decade, and on its twenty fifth anniversary has reached nearly 1000. At the end of 1987, aggregate rural banking institutions under the Co-operative Rural Banking Scheme reached 955: 282 Co-operative Rural Banks and 673 Special branches. There is little doubt that there has been a very rapid expansion of Co-operative Rural Banks which have exceeded in number the commercial bank branches in the country.

Rural banks are also fairly well distributed throughout the country on the basis of the district population, areas and the availability of other banking facilities. The geographical distribution of Co-operative Rural Banks is given in Table 2.

It is generally presumed that rural areas have low potential for savings mobilisation and consequently the establishment of such institutions is expected to result in these institutions granting credit in excess of the savings they could mobilise. The experiences of Co-operative Rural Banks have proved this presumption incorrect. After the first 5 years of their operation when there was an annual overall deficit, in the subsequent years, excluding 1974 and 1975, Rural Banks as a whole mobilised a larger amount of savings than the amount of funds they advanced for both short term lending and pawning. By 1970 Rural Banks had a surplus of Rs.7.8 million, in 1980 it had risen to Rs.191.6 million and at the end of 1987 the surplus had increased to Rs.851.4 million. At the end of 1987 Co-operative Rural Banks in all districts except Trincomalee had an excess of deposits over advances.

While the expansion of rural banks to around 1000 and its distribution fairly widely in the country and the amount of savings mobilised by them may be considered satisfactory, its function as a provider of funds for rural development has been very limited. Rural banks have demonstrated clearly the ability to mobilise small savings from among rural society, but its record of lending shows very limited activity particularly when the pawning component of lending is excluded. Advances excluding pawning have been limited to only Rs.337.8 million at the end of 1987. The amount lent on pawning was Rs.371 million. The surplus of deposits over total advances including pawning was Rs.851 million.

TABLE 2

CO-OPERATIVE RURAL BANKS – DISTRICT WISE DISTRIBUTION 1987

District	Co-operative Rural Banks Special Branches	
Colombo	59 -	69
Gampaha	94 -	97
Kalutara	46 -	47
Kandy	77 -	77
Matale	23 -	22
Nuwara Eliya	27 -	29
Galle	69 -	72
Matara	65 -	66
Hambantota	25 -	25
Jaffna	36 -	36
Mannar	08 -	07
Vavuniya	06	06
Batticaloa	10 -	10
Ampara	28 -	28
Trincomalee	13 -	13
Kurunegala	96 -	96
Puttalam	35 -	35
Anuradhapura	39 -	39
Polonnaruwa	28 -	28
Badulla	53 -	53
Moneragala	09 -	09
Kegalle	49 -	49
Ratnapura	60 -	60
	955	968

More than one half of short term loans has been for electrification of houses and water supply. Loans for agricultural production and cottage industry amounted to only about 20 percent of advances. It must of course be accepted that money obtained by pawning could have been utilised for a variety of purpose including productive enterprises. The purpose wise distribution of short term advances in 1985-87 is given in Table 3.

This deficiency in lending was highlighted several years ago by an FAO team when it said that the rural banks "unit banking functions have not been developed in the rural sector to the point of harnessing extra local resources for local rural development – this is evident in the consistent and increasing excess of rural deposits over rural advances." 2

2. **Report of the High Level Mission on the follow-up to the World Conference on Agrarian Reform and Rural Development in Sri Lanka.** The Food and Agricultural Organisation of the United Nations, 1980, p.34.

TABLE 3

PURPOSEWISE DISTRIBUTION OF LOANS BY CO-OPERATIVE RURAL BANKS

Purpose	Amount outstanding as at end 1985	%	Amount outstanding as at end 1986	%	Amount outstanding as at end 1987	%	Amount outstanding as at 30.09.89	%
1. Production of which	53.8	23.0	60.5	20.5	66.9	19.8	93.6	24.3
1.1 Agriculture	33.7		32.4		33.2		58.6	
1.2 Animal Husbandry	9.4		11.6		15.1		15.9	
1.3 Cottage Industry	10.7		16.5		18.6		19.1	
2. Housing Electrification and Water Supply	133.4	57.0	176.2	59.7	198.2	58.7	225.2	58.9
3. Debt Redemption	15.2	6.5	17.8	6.0	19.8	5.9	19.9	5.3
4. Consumption	7.3	3.1	8.4	2.8	10.9	3.2	10.4	2.8
5. Trade and other	24.4	10.4	32.4	11.0	42.0	12.4	33.0	8.7
Total:	234.1	100.0	295.3	100.0	337.8	100.00	382.1	100.0

The Central Bank has also pointed this out regularly in its Annual Reports and Review of the Economy. For instance in the Review of the Economy for 1985 it said " Unless Rural Banks make an effort to play a more active role in providing credit to the rural sector, they will continue to be merely a channel through which resources are transferred out of the rural sector to the urban centres."[3] In fact it was the inability of the co-operative rural bank to lend adequately for small enterprises which led the Central Bank to devise the system of Regional Rural Development Banks which were inaugurated in 1985.

The inability of Co-operative Rural Banks to increase their lending is undoubtedly due to several reasons. First and foremost is the fact that the local community may not in fact have viable economic enterprises for financing. The promotion of such enterprises require skills, market possibilities and entrepreneurial abilities. Mere finances will be inadequate. Therefore, these prerequisites for economic enterprises would require to be established for the finances to be utilised.

Even within the context of the given opportunities for lending, it is likely that the staff of the Co-operative Rural Bank is not geared to take risks and find it much easier to lend only where there is complete security. Such as in pawning. Lending based on projects and their viability may not find favour among the staff who may not be acquainted with the methods of appraisal nor even have the kind of orientation and commitment to encourage such lending.

In an assessment of Co-operative Rural Banks, Olcott Gunasekera has said "It may be true to say that rural banking in the limited sense of rural savings mobilisation through Co-operative Rural Banks has been successful. But in the overall development of the rural economy, rural banking has failed to make an appreciable dent".[4] While this deficiency has been highlighted of the past performance, the new perspective to development with the Government's Jana Saviya Programme could provide the basis for using Co-operative Rural Banks, an already established institution, to reorient themselves to lend to small scale employment and income generating enterprises. To use the net work of

Co-operative Rural Banks it would be necessary for the other government organisations which are involved in the Jana Saviya Programme to work out the enterprises for financing and recommend these to the Co-operative Rural Banks for their funds. This strategy is similar to the one adopted by the Central Bank through its regional offices where projects are identified by the Central Bank Regional Office and recommended for financing to the commercial bank branches in the area.

On this twenty fifth anniversary of the establishment of Co-operative Rural Banks, it is appropriate to recapture the reasons which motivated their establishment. It was recognised that while increasing the number of bank branches is necessary and important, that this alone was inadequate. There was a need for qualitative adaptations in institutions to suit rural conditions. The type of banks or other credit institutions established should be suited to the rural folk, the poor and less educated clientele. If branch banks in rural societies are of the same type as urban banks and use the same approaches in their banking, then it is likely that such banks would attract only prosperous customers such as land owners, traders and merchants, rather than the larger number of ordinary rural folk. It was recognised that bankers should go out to their rural customers rather than expect rural folk to come to them.

The development of financial institutions to serve the rural sector is not an easy task. Twenty five years ago when the first rural bank was established, it broke a tradition and was an innovative means of reaching a section of the community which had little access to the banking system and to which the banking system had difficulty in extending their activities. The Co-operative Rural Banks have been a useful instrument for savings mobilisation, it has now reached a stage when it would require to adapt itself to being a more dynamic instrument for financing enterprises within the local community rather than be only a means of savings mobilisation and an instrument for the transmission of funds from rural areas to developed sectors.

3 Central Bank of Sri Lanka, Review of the Economy, 1985, p.49.

4. Olcott Gunasekera, "Relations with the Co-operative Sector – a Metamorphosis from partner to favoured customer", in **People's Bank, In Retrospect: 25 Years of the People's Bank**, p. 59.

EXPLORING INVESTMENT POTENTIAL IN THE RURAL AREAS: WHITHER CRBS

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The Co-operative Rural Banks (CRBs) in Sri Lanka, celebrate their 25th anniversary in March 1989. When this scheme was inaugurated in 1964, the rural sector of the country was cut off from the Institutional Financial operations. However CRBs acted as a harbinger of basic banking practices to the rural countryside. Though the approach of the CRBs in the first few years was rather cautious, wherever they were in operation, these banks managed to survive the financial system within their vicinity. Manikhinna, CRB could be one such example. However, by the early 1970's the CRB scheme had moved into high gear. Its branch network grew; deposit volume expanded; and its investment pattern diversified. By 1976, CRBs registered a branch network of 503 offices, having deposits amounting to Rs.116.2 million and advances worth Rs.101.7 million.

The post 1977 era, registered a cirisis situation in the CRB system, not because these branches were unprofitable, but because they have been constantly accused of siphoning rural funds to finance urban ventures. This was despite the very high growth rate of branches, deposit accounts, deposit volumes, and advances. For instance, by the end of 1988, the CRB Branch network reached 860, and their total deposits exceeded Rs.1.8 billion. About 65 percent of these deposits have been invested in the commercial banking system of the country, showing the extent of resource extraction procern from the rural sector. (See Table 1).

Has the CRB scheme failed to achieve its objectives? Has it fogotten its intended functions and invested its resources to finance elitist operations in the centre? Has it become a creater of the development of underdevelopment in the rural sector? These are some of the serious allegations against the CRB system, and also against its creator "the People's Bank". However, they cannot be properly understood, without shedding adequate light on the socio-economic contours of the country within which these banks were operating. This paper attempts to explore the underlying reasons for the build up of surplus deposit funds of the CRBs, particularly since the mid 1970's.

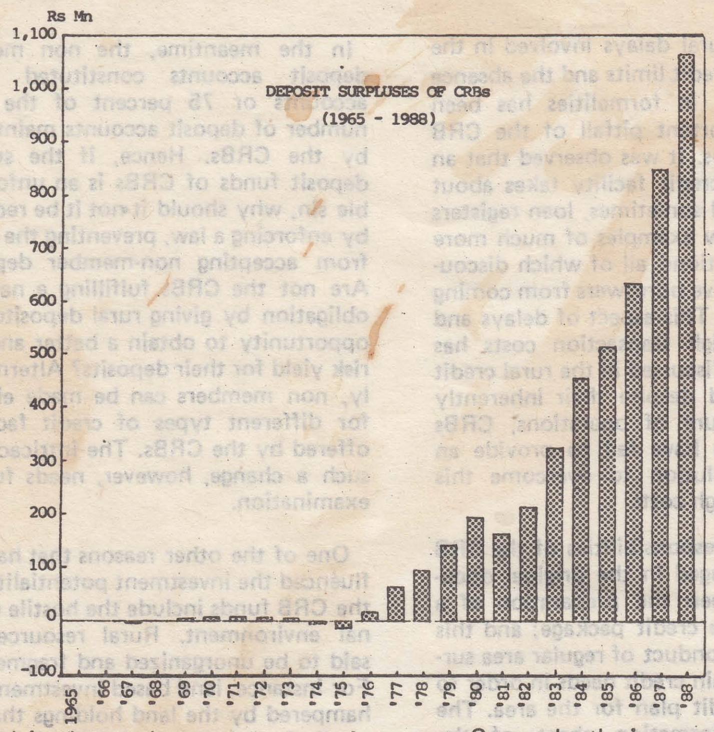
Some of the recent studies have disclosed that the occurence of surplus deposit funds of the CRBs is the natural outcome of the changes in the environment, and changes in the internal structures of the CRB system itself. Hence, the underlying reasons namely exogeneus, and endogenus.

The exogeneus reasons, refer to the socio-economic contours of the Sri Lankan economy. They are basically manifestations of the socio-economic and political conditions of the rural economy, and its relations with the other sectors. Neither the CRBs nor the entire banking system enjoy adequate leverage over their influence. The present position of surplus deposit funds of CRBs is an end result of a continued and consistent historical process, perhaps dating back to 1975 (See Graph).

The effects of the 1977 reforms notwithstanding some of their positive features have had a strong negative influence on the investment market of the CRBs. The liberalization of trade and exchange controls exposed the hitherto captive domestic market for agricultural producers of agricultural products (eg. chillies, onions, dhal etc.) cottage industries (eg. sugar, textile, paper milling) and handicrafts (eg. batiks, mask making, etc.) to ruthless wetting of market forces. The changes in the rules of the market, such as price, profit, consumer soverignity criteria etc. were new to the rural producers and they could not withstand the sudden withdrawal of state patronage and shelter. Consequently these products became highly uneco-

GROWTH OF RURAL BANKS IN SRI LANKA

YEAR	NO.OF RURAL BANKS	TOTAL DEPOSITS Rs.	TOTAL ADVANCES Rs.	INVESTMENTS IN THE OTHER BANKS Rs.
1965	8	496,360	1,167,265	(670,905)
1966	13	725,791	1,753,604	(1,027,813)
1967	27	1,371,313	2,662,689	(1,291,376)
1968	44	3,333,328	4,446,344	(1,113,016)
1969	89	6,173,145	5,395,927	777,218
1970	90	16,908,586	9,102,279	7,806,307
1971	111	17,864,410	9,316,647	8,547,763
1972	242	23,320,318	15,184,913	8,135,405
1973	341	45,154,631	38,912,146	6,242,485
1974	403	62,734,400	67,406,770	(4,672,370)
1975	447	74,214,009	87,285,572	(13,071,563)
1976	503	116,289,077	101,792,546	14,496,531
1977	544	175,462,249	110,883,300	64,578,949
1978	559	222,146,023	125,078,000	97,068,023
1979	586	271,003,019	129,251,000	141,752,019
1980	641	368,354,024	176,699,000	191,655,024
1981	743	434,048,015	271,596,000	162,452,015
1982	804	541,483,024	329,277,000	212,206,024
1983	840	683,444,717	361,261,007	322,183,710
1984	888	965,490,225	508,246,093	457,244,132
1985	914	1,087,536,439	574,811,379	512,725,060
1986	932	1,295,597,828	657,775,183	637,822,645
1997	955	1,560,178,455	708,781,964	851,396,491
1988	968	1,832,051,929	764,598,077	1,067,453,852



nomical in the newly created competitive set up in which they had to compete with imported substitutes. Few survived; but the majority fell.

The sudden reversal of the internal terms of trade penalized farmers, rural industrialists and artisans. Products from the centre, whether they be imports or otherwise, invaded the hinterland, and they replaced many local substitutes. The centre was superior and more profitable and hence attracted investments. Investors were quick to read this market, and even rural entreprenures shifted their investment patterns in favour of urban based products. Incentives such as guaranteed prices, fertilizer subsidies, etc. have not been adequate to set-off the effects of this initial shock. Consequently, ventures financed by the CRBs, during the pre 1977 era found their market shrinking and their prices contracting; and investment in these ventures became no longer attractive. Hence, the so-called adverse internal terms of trade effect was the primary reason for CRB surpluses.

In the meantime, rural deposits grew at a faster rate because of the increased direct financial flows that went to the rural sector, through state projects on housing, construction, roads, irrigation, power etc. In addition, West Asian repatriates funds, and higher prices fetched by small holders for cash crops increased the liquidity in the rural areas. However, because the rural sector was not attuned to absorb these funds, there wasn't a recycling re-investment process. Conversly, the interest rate policies of the state had been very favourable for deposit makers, as the deposit rates within the banking system exceeded 20 percent per annum. Given the gloomy investment climate in the rural sector, the prospective investors resorted to deposit making. The high priced deposits naturally increased the price levels of advances, and thereby contracted the rural investment market still further. This process of deposits exceeding advances became a common phenomenon in the banking scenario. This was amply demonstrated by drops in the call market rates, in the subsequent years. During this period, it was not only rural banks but also the other banks having branches in the rural sector that had to suffer from the problem of deposit surpluses.

The approach of the centre to this problem was rather piece meal. The emphasis was not on why things went wrong, but how the volume of advances could be increased. For this to be achieved, more and more institutions, instruments and schemes were introduced. As a result, banks, branches and credit schemes proliferated. The situation was further aggravated by the insecure investment climate in the country, particularly after 1983. While the number of opportunities available in the difficult areas got cut-off from CRB operations, the suspension of pawn-brokering business in branches located in the sensitive areas also reduced the level of operations. It is within this investment climate that the internal pitfalls of the CRBs and the related system should be examined.

The second group of reasons classified as endogeneous variables, include those falling within the manoeuvreability of the MPCs structure. This covers the broad matrix within which the Multi-purpose Co-operatives Societies (MPCs), CRBs, People's Bank and the Department of Cooperative Development (DCD) operate. Hence, this group of variables are associated with organizational structures, and management style, methods, systems and procedures followed by CRBs in carrying out their operations. It has been found that the influence of these variables were more significant determinants of the behaviour of deposits, advances and surplus deposit funds, than the exogenous variables.

As regards the organization structure of the CRBs, the distinction between the pre-reorganization structure and post-reorganization structure (1972), needs to be given adequate emphasis. The present matrix of structures of the CRBs and the importance attached to various actors within these structures can be seen as a direct outcome of the reorganization of MPCs. Some of the relevant changes that have contributed to the present position of the CRBs were:

(1) Elemination of importance attached to CRBs within the organization structures of MPCs.

(2) Downgrading of the strategic role played by the People's Bank in influencing decision making and management functions, inclusive of the supervision of CRBs.

(3) Downgrading of the importance attached to the staff of the CRBs within the broad MPCs.

Prior to the reorganization, the CRB enjoyed an autonomy and independence to function as a "rural banking institution." It was expected to maintain its own accounts and the management of each CRB was made accountable for its performance. This separation of functions, performance, and reporting methods gave the CRB its own identity and the manager of the CRB reported directly to the governing body or the Committee of management of the MPCSs. However, after the reorganization of CRB branches, special branches proliferated and in each MPCS, a post of Credit and Marketing Manager (CMM) was created to report to the General Manager of the MPCS on credit and marketing related operations. The introduction of two altogether different layers between the CRBs and the Board of Directors of the MPCs downgraded the importance of CRB related operations at the apex level of the MPCs structure.

The post of CMM was later changed to Banking Services Manager (BSM), who was responsible for inspecting mortgaged property, sanctioning of credit and recommending credit limits to the governing body at the MPCS level. Each BSM, has about two to five CRB branches or special branches under his control and in most places the level of loan processing and promotions of CRB branches depend on the charisma and effectiveness of the BSM. However, given the very low exposure of BSMs to credit operations and promotions, together with relatively low morale arising from meagre wage structures, it seems to be very unrealistic to expect an exceptional performance standard from these BSMs.

Below the BSMs, were the branch managers who were paid very low salaries (despite the recent revision made in some MPCs), particularly when compared with the industrial standards. These employees have often been interchangably used to perform various other functions in MPCs retail shops and MPCs offices. Therefore, although CRB operations contain quite a high element of banking functions — which is a specialised trade the present structure does not appear to be conductive for a growth of banking cadres for CRB operations. Therefore, with the existing staff relations, reporting systems and low incentives and wages it is very unrealistic to expect CRB staff to work on their own to find investment avenues within the rural economy; particularly when low risk, and high yielding opportunities are available outside the system.

Related to this factor has been the very high concentration of work at the BSM level. For instance, the BSM of the Ambalangoda MPCS, who had five CRBs under her supervision in 1986 had to scrutinize about 100 loan applications each month. She had to travel very widely for which no adequate compensation was provided. In general the BSM's work is hardly ever appreciated by his/her superiors.

The procedural delays involved in the approval of credit limits and the absence of flexibility in formalities has been another important pitfall of the CRB credit schemes. It was observed that an approval of credit facility takes about six weeks and sometimes, loan registers of CRBs show examples of much more extreme situations, all of which discourage prospective borrowers from coming to the CRBs. This aspect of delays and resultant high transaction costs has been widely discussed in the rural credit literature, and despite their inherently simple structure of operations, CRBs still seems to have fail to provide an acceptable solution to overcome this situation of high costs.

One of the responsibilities of the CRB staff as envisaged in the original documents has been the preparation of a comprehensive credit package; and this requires the conduct of regular area surveys to ascertain credit needs in order to prepare a credit plan for the area. The economic information sheet of the membership is used to obtain basic information required to assess credit requirements of the membership. However, in practice the ability and the capacity of the CRB staff to meet the above requirements appears to be quite limited and often far below expectations.

One of the most serious impediments to Rural Credit (See page). from CRBs to the rural sector is the stringent eligibility criteria employed by them. It starts from the question of membership. Credit facilities, other than pawn brokering, can only be accessed by those who have obtained membership in CRBs. The size of loans obtainable also has inter-alia, been a function of the numbers of shares owned by the loan applicants. In practice, obtaining as well as continuation of active membership seems to be a more rewarding exercise to many of the villagers. CRBs encourage any person seeking to open deposit accounts, and collect any amount as deposits. However, only those individuals having membership could obtain credit facilities, which gives rise to a greater number and volume of deposit accounts than the number and volume of loan accounts (advances) maintained by them. For instance, in the case of the four CRB branches observed in the Galle district, the number of deposit accounts amounted to 10,269 while the total number of loan accounts, exclusive of pawning accounts, amounted to a meagre 764.

In the meantime, the non member deposit accounts constituted 7,363 accounts or 75 percent of the total number of deposit accounts maintained by the CRBs. Hence, if the surplus deposit funds of CRBs is an unforgivable sin, why should it not it be rectified by enforcing a law, preventing the CRBs from accepting non-member deposits. Are not the CRBs fulfilling a national obligation by giving rural depositors an opportunity to obtain a better and low risk yield for their deposits? Alternatively, non members can be made eligible for different types of credit facilities offered by the CRBs. The intricacies of such a change, however, needs further examination.

One of the other reasons that have influenced the investment potentialities of the CRB funds include the hostile external environment. Rural resources are said to be unorganized and fragmented. For instance, land based investments are hampered by the land holdings that are small, fragmented and full of tenurial complications. Land is the principal source of income and also the principal source of security.

However, because land titles are unclear; their use as an investment base becomes very poor, and CRB staff tend to get unnecessarily cautious when lending to rural customers. The implications of this setting have been disastrous. Firstly, it has constrained the investment opportunities in the rural areas and thereby promoted shiphoning of rural funds to the centre. Secondly, it has also increased the involvement of intermediary parties to influence credit decisions. These parties include various pressure groups, and their influence on many occasions lead to gross violation of banking ethics, and eventually credit discipline. The net outcome is an overwhelmingly high default rate, which disqualifies both borrowers and their guarantors from any further credit.

This paper attempted to disclose some of the unpalatable truths about CRB operations, particularly with regard to their high level of surplus deposit funds. However, it does not, in any way, mean to belittle the services rendered by the CRBs on various other fronts. CRBs in fact have lit many candles to dispel the darkness of debt striken rural areas.

SAVINGS AND INVESTMENTS: MANAGING THE CRBs PORTFOLIOS

A Study of four selected CRBs in the Kelaniya MPCS Area

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Rural Banks in Sri Lanka mark their 25th anniversary of operation in March 1989. The People's Bank sponsored a scheme of rural banks from 1964 and this was a significant innovation in extending the limited banking facilities then available to serve the rural areas. The People's Bank was to be the apex hub of a network of rural banks in a system which would be a blend of the advantages of unit banking and branch banking. In the last two decades and especially since the re-organization of the co-operative sector in 1972, the Rural Banks have grown rapidly. After 1972, the Rural Banks came to be named C-operative Rural Banks (CRBs). In mid 1988 (30.06.88), 282 Rural Banks were in existence and there were a further 685 special branches affiliated to them. The expansion of the institutional financial network to the rural sector made a notable contribution to its upliftment in recent years.

Recently there have been many reports studies and theoretical discussions of the role of credit in rural development.

The importance of credit in the economy of the rural sector, and especially for the paddy farmer is a factor that engages in all these discussions. In these circumstances there have been great expectations in Sri Lanka from the banks as well as developmental agencies. One advantage of using the Rural Banks to channel credit to the small farmer is that they are part of a very wide network throughout the island serving the highly scattered rural people. Another advantage is that people even in the remotest villages have been associated with the co-operative movement known in Sri Lanka for almost 70 years. How far these banks have served the varying needs of the rural people and their potential is the subject of this study.

Objectives of the Study

The study objectives are listed below as follows:

1. To examine the trends of the Deposits and Advances portfolios of the selected CRBs.
2. To analyse how far the selected CRBs have been successful in mobilizing rural savings for the development of the sector.
3. To compare the study results with the overall performance of CRBs in Sri Lanka.
4. How modifications could be introduced to the CRBs.

Methodology

As at end of 1988, the total number of CRB offices stood at 6 in the Kelaniya MPCS area in the Gampaha District. This study is based on field work carried out in 4 selected CRBs in the Kelaniya MPCS area namely Wedamulla (1973), Kelaniya (1981), Wanavasala (1981) and Peliyagoda/Pattiya (1986). Since there are six CRBs spread all over the Kelaniya MPCS area, it is difficult to make an indepth study of savings and investment portfolios of all the CRBs. Therefore, 4 CRBs are selected on a purposive basis.

A detailed study of the performance of these selected CRBs with varid experience was undertaken for the period 1981-1988. Accordingly, from the available records at the Kelaniya MPCS and the CRBs, their savings and advances were obtained for the period from 1981 to 1988. When clarifications were necessary, they were obtained from the officials of the MPCS as well as the CRBs. The figures are regularly audited by the officials of the Co-operative Department.

Further, for the purpose of comparison with the overall performance of CRBs in Sri Lanka the published data on deposits and advances were also collected from available sources.

Deposits of the Selected CRBs

Under the rules of the CRBs any member of the public, whether a member of the MPCS or not, could deposit money in the rural bank.

Total Savings and Fixed Deposits of the selected CRBs by the end of 1988 amounted to Rs.9,546,000. This was an increase of Rs.1,690,000 or 22 percent compared to the position as at the end of 1987. All these four CRBs have made remarkable progress in deposit mobilization as shown in Table 1. For example, the deposits with the Wedamulla CRB at the end of 1981, was only Rs.1,276,000

TABLE 1 DEPOSITS OF SELECTED CRBS IN THE KELANIYA MPCS AREAS 1981 TO 1988

(Rs.1000)

	Wedamulla			Kelaniya			Wanawasala			Paliyagoda–Pattiya		
Year	Savings Amount	Fixed Amount	Total Amount	Savings Amount	Fixed Amount	Total Amount	Savings Amount	Fixed Amount	Total Amount	Savings Amount	Fixed Amount	Total Amount
1981	845	431	1276	57	16	73	–	–	–	–	–	–
1982	1366	619	1985	207	81	288	166	43	209	–	–	–
1983	1632	657	2289	457	58	515	345	103	448	–	–	–
1984	2057	534	2591	551	82	633	599	153	752	–	–	–
1985	2916	244	3160	856	33	889	575	154	729	–	–	–
1986	3207	292	3499	1167	108	1275	933	158	1091	182	15	197
1987	3861	451	4312	1414	104	1518	1255	263	1518	499	9	508
1988	4576	402	4978	2014	95	2109	1574	110	1684	768	7	775

* Pattiya CRB established in 1986.

Source: *Survey of selected CRBs in the Kelaniya MPCS Area.*

TABLE 3

TOTAL ADVANCES OF THE SELECTED CRBS - 1981-1988

(Rs.1000)

	Wedamulla			Kelaniya			Wanawasala			Peliyagoda-Pattiya		
Year	Pawning Amount	Short-term Amount	Total Amount	Pawning Amount	Short-term Amount	Total Amount	Pawning Amount	Short-term Amount	Total Amount	Pawning Amount	Short-term Amount	Total Amount
1981	791	31	822	156	–	156	–	–	–	–	–	–
1982	641	31	672	295	22	317	52	20	72	–	–	–
1983	856	24	880	542	53	595	219	53	272	–	–	–
1984	1389	40	1429	728	13	741	426	46	472	–	–	–
1985	1872	127	1889	817	17	834	606	39	645	–	–	–
1986	1956	175	2131	1078	12	1090	735	89	824	–	–	–
1987	1834	181	2015	978	118	1096	688	78	766	384	5	389
1988	2418	174	2592	1406	160	1566	856	50	906	1356	15	1371

Source: *Survey Data*

and the deposits with the P/Pattiya at the end of 1986 was only Rs.197,000 and the deposits increased nearly fourfold to Rs.775,000 by the end of 1988. Similar progress in deposit mobilization could be seen in the use of the two other CRBs. Increases are more significant in savings deposits than in fixed deposits.

It is significant that these banks have been able to mobilise a large volume of savings from the area, which means that they have acted as a catalyst in mobilizing savings from the operative area.

TABLE 2 NUMBER OF TOTAL DEPOSIT HOLDERS & LOAN RECIPIENTS OF SELECTED CRBS ON 1981 TO 1988

Year	No. of Total deposit holders (Savings & Fixed)	No. of Loan recipients (Short-term)	No. of Loan recipients (Pawning)
1981	2818	60	1385
1982	5012	72	1258
1983	7466	90	1919
1984	8189	77	2725
1985	8890	63	3388
1986	10040	115	3963
1987	10995	156	4122
1988	11717	145	4517

Source: *Survey Data*

Both the volume of savings and the number of savers bear witness to this phenomenon (Table 2). The pooling of all these idle funds would make substantial amounts available in the hands of banking institutions for their lending operations. Hence streamlining of the banking operations of these institutions could help a great deal to increase the rural savings and popularize the banking habit in rural areas further. However, it is most unfortunate that the successes achieved in terms of mobilization of deposits have not been matched by improvements in the supply of credit.

As at 1981 the number of deposit holders stood at 2818 while in 1988 there were 11,717 deposit holders. This was an increase of 8899 deposit holders or 315 percent compared to the position as at the end of 1981. Although there has been a dramatic increase in the number of deposit holders, the same does not seem to have occured as far as loan recipients (short-term) are concerned. Thus in 1981 the number of persons making use of loan facilities in CRBs stood at 60. The corresponding figure for 1988 is 145. This was an increase of 85 loan recipients or 141 percent compared to the position as at the end of 1981. This shows a very slow growth in number of deposit holders. (Table 2).

Loans and Advances – Short Term Investment Outlets

The CRB scheme recognises the importance of the village level co-operative societies as the medium through which members could obtain their credit requirements for a wide range of essential needs. Those eligible for loans from rural banks are those who are members of the co-operative society and those who already have deposit accounts in the rural banks. The line of financing of the CRBs covers agricultural production, animal husbandry, cottage industries, debt redemption, electrification, consumption and relief of distress.

The total amount of short-term loans granted by the four CRBs stood at Rs.399,000 in 1988. The total advances made by the four CRBs under the pawn broking scheme were Rs.6,036,000 by the end of 1988. Thus the total amount of loans (Pawn-broking and short-term) granted by the selected CRBs amounted to Rs.6,435,000 ub 1988. Of the total loans granted in 1988, 40 percent had been granted by the Wedamulla CRB and 25 percent by the Kelaniya CRB. The Wanavasala CRB's share of total loans was 14 percent. The relative share of the P/Pattiya CRB in total loans granted was 21 percent. (Table 3 and 4).

Pawn Broking Activities

CRBs also function as a pawn broking agent of the People's Bank. This may be considered the most successful lending operation of the CRBs. CRBs could

TABLE 4

THE TOTAL AMOUNT OF PAWN-BROKING AND SHORT-TERM LOANS GIVEN BY THE SELECTED CRBS 1981–1988

(Rs.1000)

Year	Total Pawning	Total Short-term	Total Amount
1981	947	31	978
1982	988	73	1061
1983	1617	130	1747
1984	2543	99	2642
1985	3295	183	3478
1986	3769	276	4045
1987	3884	382	4266
1988	6036	399	6435

Source: *Survey Data*

engage in pawning either with their own funds or after obtaining overdraft facilities from the People's Bank.

In contrast to short-term loans, pawn broking activities have increased very significantly. In 1981 the number of persons who had pawned stood at 1385 whereas this figure had increased to 4517 by 1988. (Table 2) . The total volume of pawning advances shows rapid increase. In 1981; the total amount of Pawning Advances, which stood at Rs.947,000 increased to Rs.6,036,000 by 1988.

The data provided in Table 5 shows the purposewise loans given by the selected CRBs taken together. As at the end of 1988, the total advances of the selected CRBs stood at Rs.6,402,000. The highest proportion of short-term loans, namely, 80 percent had been granted for Housing, followed by Debt Redemption (13 percent) and Trade (4 percent). The total amount of loans granted under pawn-broking was Rs.6,036,000 in 1988. Loans under Pawn-Broking accounted for 94 percent of the total advances (short-term and pawn broking). This is the highest item among the total advances.

TABLE 5

PURPOSEWISE LOANS OF SELECTED CRBS AT 31ST DECEMBER 1988

(Rs.'000)

Purpose	Amount	Percentage
Agriculture	1	0.3
Housing	293	80.0
Debt Redemption	47	13.0
Trade	15	4.0
Electrification	–	–
Other	10	2.7
Total (Short-term loans)	366	100.0
Pawn broking	6036	94.0
Short-term loans	366	6.0
Total Advances	6402	100.0

Sources: *Survey Data*

Savings Mobilization

The net deposit position of the four CRBs showed a significant improvement from 1981 to 1988. Table 6 shows that the total of all CRB deposits have every year exceeded advances (D/A). This table also shows that the banking activities of the four CRBs have increased over the years and it appears that their capacity to mobilize savings has widened as shown by the improvement in the net deposits position. Between 1981 and 1988, the annual excess of deposits over advances has grown from Rs.370,000 to Rs.3,111,000.

TABLE 6

TOTAL DEPOSIT' ADVANCES AND NET POSITION OF THE SELECTED CRBS 1981 - 1988

(Rs.'000)

Year	Total Deposits	Total Advances	Differences between T/Deposits & T/Advances
1981	1340	970	+ 370
1982	2482	1061	+ 1421
1983	3252	1747	+ 1505
1984	3976	2642	+ 1334
1985	4770	3378	+ 1392
1986	6062	4045	+ 2017
1987	7856	4266	+ 3590
1988	9546	6435	+ 3111

Source: *Survey Data*

Thus, the growing net positive deposit positions in the past indicate that the CRBs in the Kelaniya MPCS area have not been successful in utilizing the resources within the same area from where they were mobilized. There is considerable scope for increasing loans in the area for various activities. However, the total credit provided by the selected CRBs to the area, for a variety of reasons, falls far short of the requirements. This apart, their major emphasis in this sector has been on the provision of short-term finance to the neglect of investment credit which is vital for increasing productivity. Moreover, very little has been done by them for providing credit support to various other activities in the area. As mentioned earlier, the lending of CRBs were confined mostly to Housing, Debt Redemption and Trade Loans and very little had been done in the sphere of investment credit. From this situation it is evident that the rural banking system should adopt a more diversified and positive approach to the development problems of the area .

Considerable improvement observed in net positive deposit positions in an indication of the transfer of funds from the Kelaniya MPCS area to other areas, particulary to urban areas, in spite of the growing credit requirements in this area. Hence, it is necessary to adopt efficient measures to retain some of these funds in the area for its own development. It is important that banks actively promote mechanisms siphoning off the surpluses that are being generated in the rural areas. Aconscious effort must be made to increase availability of these supluses through credit in the rural sector itself. This in turn would provide incentives for entrepreneurs to locate new economic activities in these areas. This would generate positive employment and income effects. Unless rural banks make an effort to play a more active role in providing credit in the operational area they will continue to be merely a channel through which resources are transferred out of the area to urban centres.

Investment of Surplus Funds

The People's Bank provides facilities for CRBs to invest their surpluses in the form of Fixed and Saving Accounts. In addition CRBs also invest their surpluses in the National Savings Bank when their rates are more favourable. Table 7 shows that investment of all CRBs in the period 1986-88 was at a much higher level than in the previous five years.

This trend shows that under the existing credit system a substantial portion of the deposits mobilized within the area are invested in activities located in other areas which promise a higher rate of return.

The CRBs themselves make their major investments in deposit accounts in the People's Bank and thereafter Rural Savings find their way into the general financial activities of the People's Bank. The more significant of these activities generally belong to the growth areas of recent times namely construction and external and internal trade. Such activities are certainly imported and vital for the development of the economy. But, the importance of this fact is that savings from the rural sector are not being fed back to the rural sector, but are being channelled elsewhere. In this context, one may even say that banks have contributed to the 'development of rural under development' by being instruments of resource transfer.

The WCARRD Report (Report of the High Level Mission on the Follow-up the World Conference on Agrarian Reform and Rural Development in Sri

TABLE 7

USES OF RESOURCES OF ALL CRBS IN THE KELANIYA MPCS AREA 1981-1988

Year	People's Bank	National Savings Bank	(Rs.'000) Total
1981	200	–	200
1982	600	250	850
1983	450	–	450
1984	200	–	200
1985	200	–	200
1986	1050	–	1050
1987	2550	–	2550
1988	1850	1000	2850

Source: *Survey Data*

Lanka, July, 1979, p.21) has emphasised in its study that *"in effect the rural surplus is extracted by the banking process mainly for use outside the rural sector (viz. urban and rural elite consumption, industry, trade, services, etc.) leaving the rural sector in a chronic and worsening condition of rural under development."* Under these circumstances, CRBs have been called upon to review their strategies and approaches to meet the needs of the rural people.

Overall Trend

We can now compare the result of overall performance in Savings Mobilization by CRBs in Sri Lanka with that of the study result. The data provided in Table 7 show the growth in number of the CRBs, and their aggregate deposit and advances since 1981. As at 30th June 1988, the total number of CRB offices stood at 967. As against total deposits of Rs.1,750 million, at mid 1988, total advances amounted to only Rs.742 million; resulting in a surplus of resources with the rural banks to the tune of Rs.1,009 million. Between December 1981 and June 1988, the annual excess of deposits over advances has grown from Rs.162 million to Rs. 1,009 million. According to districtwise data provided by the Central Bank of Sri Lanka, (Economic Review – 1987) only Trincomalee District had the reversed situation and the highest volume of excess deposits of Rs.161.6 million was reported from Gampaha District. An increasing trend in excess resources has been observed over the last 8 years. Despite, the substantial growth in resources, CRBs have made very little attempt at channelling funds for productive investment purposes locally.

The WCARRD report (1979, p.34) also emphasised this trend as follows:

"Since 1964, over 600 rural banks have been formed with the help of the People's Bank, and these banks have indeed mobilized a substantial amount of rural savings. But,

(i) Unit banking functions have not been developed in the rural sector, to the point of harnessing extra local resources for local rural development. This is evident in the consistent and increasing excess of rural deposits over rural advances;

(ii) The People's Bank has become primarily a commercial bank which uses its capacity to mobilize rural savings for conventional bankable projects in industry, trade and services, mainly in urban areas."

TABLE 8

TOTAL DEPOSITS, ADVANCES & NETT POSITION OF THE ALL CRBS IN SRI LANKA - 1981 –1988

Year	No. of CRBs	Deposits Total Amount	Advances Total Amount	(Rs.'000) Difference between T.Deposits & Advances
1981	746	434048	262596	+ 162453
1982	804	541484	329272	+ 212272
1983	843	717981	391612	+ 326369
1984	888	905490	508247	+ 397243
1985	914	1087536	574811	+ 512725
1986	932	1295595	657775	+ 637820
1987	955	1560178	708782	+ 851396
1988	967	1750845	742273	+ 1008572

In the majority of the districts in Sri Lanka deposits exceed advances and in effect, the rural surplus is extracted by the banking process mainly for use in the urban and trade sectors leaving the rural sector in a worsening condition of under development. The Central Bank of Sri Lanka has emphasised this situation in its Review of the Economy for 1986 as follows:

"The growing excess of deposits over the loans indicates that over the last decade an increasing volume of resources had moved to urban centres from rural areas. However, such transfer of funds from rural areas may not be due to a lack of demand for credit in rural areas. There is a demand for capital, particularly medium and long term investment capital, for development purposes such as agriculture, fisheries, animal husbandry, and small industries in rural areas. Therefore, as repeatedly pointed out in earlier years, the Rural Banks should explore the possibilities of expanding their credit portfolio for development oriented purposes. The Rural Banks should develop necessary institutional infrastructure for expansion of their lendings for various economic activities in the rural sector. (p.51)

Conclusion

Rural development has always been regarded as of crucial importance for promoting economic development of the country. Similarly, the role played by credit in promoting economic activities have never been in doubt. Traditionally the rural sector in Sri Lanka has depended on non-institutional sources for credit. The major problem of informal lenders is the high interest rate, which necessarily increases the cost of production when used for productive purposes. On the other hand, if credit is supplied from institutional sources at cheaper rates the cost of production can be reduced substantially. In this respect, there have been great expectations from CRBs as rural level development institutions. Moreover, the vicious circle of poverty in the rural sector provides the key note to the use of banking as a tool for development.

Despite the substantial growth in resources, rural banks have made very little attempt at channelling funds for productive investment purposes. Instead, CRBs were attracted to short-term investment outlets in the money market.

The growing net positive deposit positions of the CRBs indicate that the banks have not been successful in utilising the resources in the same areas from where they were mobilized. However, this may not be due to the lack of demand for credit in these areas as undoubtedly there is considerable scope for increasing loans in these areas for agriculture, animal husbandry, handicrafts, trade, services and various activities. On the whole, it appears that transfer of resources from rural areas to urban and trade areas continues to take place via the CRBs as indicated by excess of deposits over advances made by these institutions.

Since the rural economy requires a substantially higher amount of institutional finance than what is granted now for its development this situation has to be changed soon enabling the rural sector to obtain a larger volume of credit. However, experience shows that the CRBs developed under People's Bank are influenced and have developed on the same lines as the People's Bank itself and do not appear to have an identity of their own as a rural based institution. It can be said that rural banking in Sri Lanka still suffers from deep structural weakness in relation to the development requirements of the rural economy. A new approach, a new attitude, and a different methodology is therefore necessary to meet the needs of the rural people. Their main emphasis will be on providing credit support to the activities which are capable of generating employment and raising income levels of households in rural areas.

CO-OPERATIVE RURAL BANKS:
New ideas for Development

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Sri Lanka Institute of Co-operative Management

The CRB and Its Setting

Co-operative Rural Banks (CRBs) which now function under Multi-purpose Co-operative Societies (MPCSs) were set up in 1964 to cater to the financial needs of the rural population. At present every one of the 282 MPCS have one or more CRBs. It is believed that about 85 percent of the need for rural banks is now satisfied with this network of banks. The CRBs are managed by the MPCSs through an officer called the Bank Services Manager (BSM) to whom the CRB managers report. The Bank Services Manager, who also may sometimes be called upon to handle other functions such as paddy purchasing, reports to the General Manager. All MPCSs will have in addition to the Rural Banking Division, a Consumer Division and a Transport Division. Some MPCSs will have other commercial activities as well such as rice mills, printing presses, cinemas, milk collection centres and channelled consultation chambers. With such numerous and diverse activities it is quite possible that at General Management level and at board level the rural banking activities do not receive the attention they need.

In spite of many obstacles, the CRBs have shown a remarkable growth in collecting rural deposits; although the granting of project oriented lending has not been so impressive. The growth in pawning advances is also significantly high, indicating the usefulness of the CRB pawning facility, if not for which this business would have fallen into the hands of the informal sector which may have caused more hardship to the rural poor. However, growth alone cannot be used as an indicator of the satisfaction of the financial needs of the rural population nor can it be used as a means of assessing the future needs that require fulfilment.

A long tradition exists in the supply of rural credit on a co-operative basis, commencing with the first co-operative credit society in 1906 in Dumbara. There are several landmarks in rural credit such as the Co-operative Societies Ordinance of 1911, the establishment of the Co-operative Federal Bank in 1949 and the establishment of the People's Bank in 1961. At the same time the co-operative movement too went through some major changes such as the setting up of a large number of consumer societies during the War, the MPCS scheme in 1957 and the Re-organisation of 1971. Hindsight reveals many incorrect assumptions which influenced these changes. The present situation is that Co-operative Thrift and Credit societies under the apex Co-operative Thrift and Credit Union is one stream while the CRBs under the MPCSs is another.

Life Cycle of the CRB

While analysis of performance of CRBs is important I believe that it is time we looked at CRBs from another angle; a Marketing one. In the case of a consumer product the producer is always concerned about the life cycle of his product. In the same manner we must attempt to determine the stage at which the CRB concept is in its life cycle. A product life cycle goes through four stages: Introduction, Growth, Maturity, and Decline. It is easy to determine the Introduction stage and the Growth stage, but the Maturity and the Decline stages are difficult to see. A correct understanding of the concept of Product Life Cycle is important so that Maturity and Decline can be identified when it takes place so that a new growth period is introduced with new development strategies. With the rapid and far reaching changes in the banking sector and the rural economy it is therefore advisable to constantly monitor performance trends, and attempt to chart the Life Cycle of the concept of the CRB.

In the flow of a consumer product from the manufacturer to the consumer three factors predominate in importance: the product concept must be right and must be available at the right price, the actual product must have the required quality and required reliability, and the product must be promoted. We must question whether the CRB concept caters to the wants of people at the right price, whether it is being adequately promoted for customers. Answers to these questions will lead to various strategic and operational plans hopefully leading to an extended life cycle for the CRB concept.

CRB as a Marketable Service

Every organisation or a distinct division of an organisation has a declared Mission which stems from the purpose for which the organisation is in existence and from its principal values. In order to fulfil its mission an organisation may embark on one or more strategies some of which may not directly result in the fulfillment of the mission. For example, a particular mission may emphasise subsidies to poorer sections of the population while one or more strategies will deal with providing some product or service to higher income groups. This strategy will be purely for the purpose of generating surpluses which can be used to grant the subsidies envisaged. Many traditional co-operators are reluctant to embark on activities that service more affluent segments of the population even as an income generating strategy for fear of being branded anti-co-operators and capitalist supporters. This has been one of the principal reasons for the poor economic performance of co-operatives; the failure to separate the mission from strategies.

There is no reason therefore why CRBs should not provide services to segments of the population other than members and the rural poor. Through the process of SWOT analysis (analysis of Strengths, Weaknesses, Opportunities and Threats) improved and new services could be developed to cater to enlarged or new customers.

The growth sector analysis technique as shown in Fig. 1 is a useful tool to generate new ideas for increasing the customer base as well as types of services provided.

For this purpose a segmentation of members and prospective customers in the catchment area needs to be done. Segmentation can be on more than one factor: segmentation on disposable income; segmentation on trade, profession or vocation; segmentation on cultural habits etc. During the present turbulent times several corporate customers have made use of CRBs for such services as payment of salaries of employees and cashing of cheques. Some institutions even wish to open accounts with CRBs. It therefore seems possible to expand services in both directions: improved and new services and enlarged and new customer base.

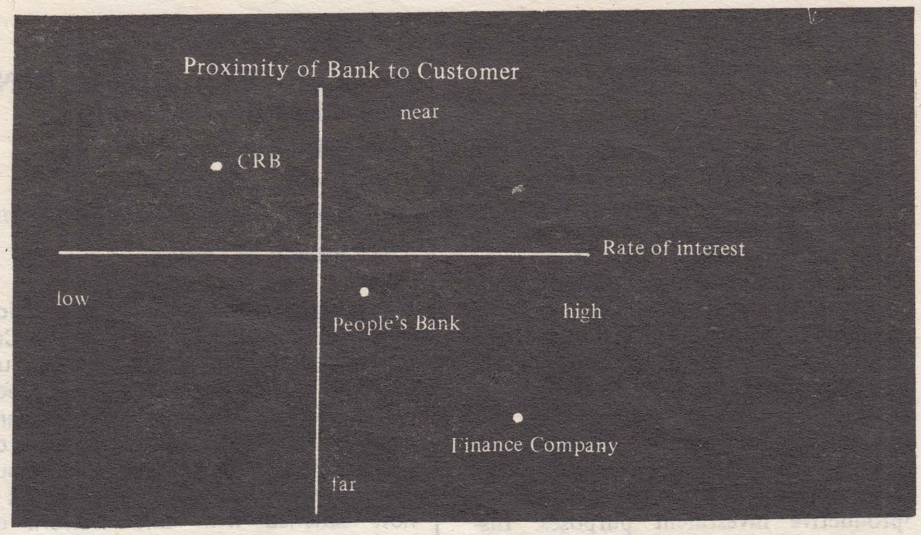

Fig. 2. POSITIONING DIAGRAM SHOWING CRB AND COMPETITORS

In determining the right type of service, another useful technique is the product positioning diagram, which compares (on a two-dimensional grid) the services offered by competitors with your own service. This comparison which can only be done for two attributes at a time is very useful to determine an area not served by the competitors. For example Fig. 2 shows the fixed deposits schemes of different institutions on two scales; proximity of Bank or institution and rates of interest.

This particular diagram (taken as an example only and not a calculated positioning) indicates a good positioning of the CRB as it is not closely positioned to a competitor. A close position would lead to high competition. This technique can be used to modify existing services and determine new services having unique selling advantages. The attempt should be to have innovative thinking free of all artificial restraints so that new and improved services can be thought of.

Efficiency of Operations

After the improved and new services have been conceived the next most important activity is to analyse the strengths and weaknesses that influence the quality and reliability of the services. In oder to have high quality and reliability it is necessary for CRBs to operate with efficiency and effectiveness. Some of the major weaknesses in CRB operations are as follows:

a) low skills and knowledge of CRB managers and Bank Service Managers.

b) low level of motivation of all CRB personnel.

c) low level of concern and supervision by General Manager and Boards of Directors.

d) low member interest in the supervision and monitoring of CRB activities.

	Existing Services	Improved Services	New Services
Existing Customers		More efficient services	eg. New types of loans New savings schemes New types of account etc.
Enlarged Customer base	More promotion of services	Market segmentation and differentiation of services	New services attracting more member interest
New Customers	Development of new customers (eg. corporate customers)	Extend market of new customers for improved services	eg. New services for corporate Customers

FIG. 1 GROWTH VECTOR ANALYSIS OF CRB'S

e) inadequate supervision by People's Bank staff.

To overcome these weaknesses many institutions have been providing training and some monitoring but the results have not been very encouraging. Some of the recommendations to improve efficiency are given below.

(i) FINANCIAL INCENTIVES – Some MPCS have introduced financial incentive schemes while the majority have not. Some argue that even without incentives CRBs make good profits and therefore incentives are not required. This is due to the misunderstanding of what an incentive scheme is. It is possible to design a multifactor incentive scheme so that not only profits but several other measurable attributes of efficiency can be improved. Also, successful incentive schemes provide rewards up the heirarchy according to the contribution that higher officers can make. This means that the General Manager also must receive an incentive based on CRB performance. Incentive payments on this basis will result in motivating all relevant persons to improve CRB performance.

(ii) COMPUTERISED DECISION SUPPORT SYSTEMS – Training in feasibility analysis of projects etc. required for lending decisions have limitations. Techniques such as Sensitivity Tables and Cash Flow Forecasting are time consuming and sometimes difficult for CRB managers with only basic educational qualifications to master. The solution is to have a small personal computer at each MPCS (not at each CRB) where different types of sensitivity models and cash flow models are installed using a simple spread sheet programme so that decisions can be made purely by feeding in the required input data. Also, databases can be created so that information on commercial ventures, such as their profitability and availability of skills and raw materials will be stored for easy retrieval. Demand forecasting by extrapolation and even with co-relation can be carried out very easily by computer.

(iii) COMPUTERISED MANAGEMENT INFORMATION – CRB management is poor at present. Sometimes even information on past due loans is also not readily available. With a computerised information system it will be possible even for the General Manager, Bank Service Manager and the officers of the People's Bank to retrieve information in many useful ways from the data stored in the computer. It will also be possible to generate on a monthly basis financial and other performance indicators which will help officers of the Co-operative Department and consultants of the Sri Lanka Institute of Co-operative Management (SLICM) to more closely monitor the performance of each CRB. Although we are in the age of decentralisation and devolution, centralised monitoring and feedback advice becomes necessary when the required skills and expertise is not available at the peripheral units.

(iv) ALLOCATING RESPONSIBILITIES TO SENIOR MANAGEMENT AND BANKS – Recently the Ministry of Finance and Planning has been considering allocating more responsibilities to senior management of state corporations. Regular performance reviews are to be submitted by such officers to the Boards of Directors. Also a structured agenda has been recommended for Board Meetings. A similar system can be introduced in MPCSs too so that adequate focus is made on CRB activities. Review of CRB activities in terms of goals set for them could be made a compulsory item on the agenda of Board Meetings. The Annual General Meeting too could highlight CRB activities. The idea is to get the CRB more into focus so that consumer activities do not overshadow it.

Implementation of these is likely to result in increased efficiency and effectiveness. However, there are many other ways – with major structural modifications – through which efficiency can be increased.

The Promotional Mix

The third most important activity is Promotion. No matter how good the type of service offered is or how efficient the operations are the full potential is not usually realised unless the offered services are promoted. Inspite of the long years of existence of the CRB and their closeness to the members I do not believe that all prospective customers are aware of the types of facilities offered by the CRBs. In the event of new facilities and attracting new customers such as corporate customers it becomes even more important to promote such facilities.

In the same manner as the promotion of a consumer product, CRB services must also be promoted using the usual promotional mix: personal selling, advertising, publicity and sales promotion.

Advertising is a powerful method for building up awareness of products or services. Even though other promotional methods may be more useful for the comprehension stage and conviction stage of a transaction cycle, awareness of a product or service is a prerequisite. Mass media advertising is unnecessary for individual MPCSs but all standard CRB services could be advertised on a national level. Direct mail will be a useful method for creating awareness among corporate customers. Outdoor posters and indoor posters may be useful in creating awareness among the local population. CRBs usually do not have any leaflets or notices within the building giving details of services and eligibility criteria. According to some SLICM consultants, members and other prospective customers could be attracted to avail of CRB services if such information was available more readily.

Publicity is effected through news items on radio, TV and the press and also through other public exposures. It is very advantageous because it is free. CRBs have not made much use of publicity inspite of many newsworthy activities. CRBs can be given a great lift up with a publicity boost; this will help build up confidence in the CRBs.

Sales Promotion is not a useful tool in the case of CRBs. However to a limited extent promotions can be implemented by such competitions as, the lucky depositor of the month, the best depositor of the year, the best loan repayer etc. Success stories of those who obtained project loans and developed themselves can be used to serve as demonstrations.

The foregoing are some suggestions deviating from the traditional path of finding ways and means of developing CRBs. It is intended to serve as 'food for thought' by policy makers and those directly engaged in the provision and development of CRBs. Using a Marketing approach and making use of modern technology to improve efficiency is necessary, for CRBs to grow and make a more useful contribution to improve the standard of living of the rural poor.

Trends in the Economy in 1988

Sri Lanka's economic performance in 1988 fell considerably below expectations with the Gross National Product (GNP) recording a growth of only 2.5 percent. It is described by the Central Bank as a "modest recovery" when compared with the poorer performance of a 1.6 percent GNP growth rate in 1987. The comparative figures for Gross Domestic Product (GDP) growth rate were 2.7 percent in 1988 as against 1.5 percent in 1987.

Agriculture

The "modest" growth rate in 1988 is attributed mainly to an improvement in agricultural production. As the Central Bank records it "The agricultural sector recovered considerably in 1988 from the drought affected low production levels experienced in the preceding year. Most tree crops and field crops recorded improved performances in 1988, compared with 1987. Tea production increased by 6 percent to a record 227 million kgs. in 1988, while rubber production also rose marginally to reach 125.5 million kgs. However, coconut production declined substantially by 16 percent to 1,933 million nuts — the lowest level since 1978. Paddy production which suffered during the previous two years due to unfavourable weather and unsettled conditions in the Northern and Eastern regions, recovered sharply to register a 16 percent growth and an output level of 2.5 million metric tons. The performance of both minor food crops and minor export crops was also favourable."

Industry

The industrial sector also showed an expansion in 1988, despite the adverse conditions facing manufacturers in the latter part of the year. In real terms, industrial output is estimated to have increased by 6 percent in 1988, a slightly lower rate of growth than in the previous year. The output of private sector industries is estimated to have increased by 11 percent, while production in public sector industries declined by 1 percent.

Energy

The energy situation in the country also showed improvement in 1988. There were increased opportunities for hydro-electrical generation; while the decline in oil prices in the international market also contributed to a better performance for the energy sector.

There were several minus factors in Sri Lanks's economic performance in 1988. The adverse circumstances that confronted the economy, resulting particularly from the escalation of civil disturbances and also unsettled conditions connected with two major general elections facing the country, led to a serious deterioration in the budgetary situation, an excessive growth in the money supply, an escalation of consumer price levels, and unfavourable trends in the balance of payments with external reserves continuing to fall heavily.

Money Supply

A significant adverse development in 1988 was the considerable acceleration in domestic credit. All components in the money supply rose during last year, the most notable being the currency component which increased by as much as 37 percent over that of 1987. This increase was to an extent caused by the high preference for liquid cash by businessmen and the public owing to the escalation in the civil disturbances during the latter part of the year. Together both currency and demand deposits increased by 29 percent by December 1988 as against an 18 percent increase by December 1987 and 13 percent by December 1986.

Credit granted to the private sector, including Public Corporations recorded the sharpest growth in 1988. Several private sector enterprises and major Public Corporations such as Petroleum, State Plantations, JEDB and C.W.E. were threatened by liquidity problems due to the difficulties in obtaining funds and they were compelled to take precautionary measures of raising additional funds for their working capital requirements. Commercial Bank credit to Public Corporations increased mainly due to these heavy borrowings.

Balance of Payments

The sharp growth in money supply resulted in an expansionary impact on the economy. Fortunately this expansionary effect was moderated due to the decline in the country's net external banking assests. Sri Lanka's balance of payments position weakened to a large extent in 1988. The causes were mainly a slow growth in export earnings, increased import payments, decline in the earnings from tourism, higher interest payments on foreign loans, a slower flow in private transfers, reduction in private foreign investment and larger amortization payments of foreign debts.

The effect of all these adverse trends was an overall deficit of Rs.5,000 million (SDR Rs. 101 million) in the overall balance of payments as compared with a deficit of Rs.1,801 million in 1987. The massive payments deficit in 1988 had to be financed by running down external reserves. The level of gross external assests at the end of December 1988 stood at SDR 298 million as compared with assests worth SDR 415 million in 1987. This level of gross external assets at the end of 1988 was sufficient to meet only 2½ months of imports projected for 1989, which compares with a position of 3.7 months of imports in 1987 and 4.4 months of imports in 1986.

Government Finance

The budgetary performance in 1988 also reflected negative trends, particularly a deterioration in the fiscal position. Government revenue showed only a marginal increase, with lower collection of revenues due to the unsettled conditions. There were also increased commitments on account of several items of current expenditure such as salaries and wages, drought relief and the Food Stamp scheme. In addition, a large number of supplementary capital expenditure programmes were permitted for ongoing development activities. The result was an overall increase, in the budget deficit, of 11 percent of GDP in 1987 compared to 15 percent of GDP in 1988. The widening of the budget deficit was a combined outcome of slow growth in government revenue and a larger increase in expenditure. The resulting resources gap of nearly Rs 11 billion had to be financed from banking sources. This resulted in an expansionary financing of the budget deficit.

Prices

Consumer prices showed an increase of 14 percent during 1988 over the average level of 1987. This was almost twice the increase recorded in the previous year. Much of the increase in prices was due to higher food prices. Meanwhile, the Wholesale Price Index, maintained by the Central Bank, also showed a sharp upward movement during the year (17.8 percent), indicating considerable price pressure at the primary market level as well.

Our January/February 1989 and March 1989 issues will carry more details of how the economy performed in 1988.

REGIONAL DEVELOPMENT STRATEGIES AND THEIR IMPACT ON REGIONAL DISPARITIES IN SRI LANKA - An Appraisal of the Local Development Approach 1971 - 1981

P. Sumanapala

Based on a Research Paper submitted for a Masters' Degree at the ISS in the Hague.

Introduction

The necessity for Regional Development Planning could be viewed mainly from two aspects. Firstly, in practice, most countries (especially Third World countries) are facing the problems of agglomeration of economic activities and concentration of population in and around the metropolitan regions or in other more urbanized regions. Secondly, normally sectoral plan formulations, resource allocations and other related decision-making under the national planning system is carried out by policy makers and planners working at the capital cities or other regional cities where head offices and administrative institutions are located. In this situation, there is a tendency towards an urban bias in making decisions and allocating resources.

The nature of the regional development approach is always based on the system of national planning in a particular country. Having considered these relationships in the Asian context, Yogo has identified three major approaches known as the Regional Resource Development Approach (RRDA) Comprehensive Regional Development Approach (CRDA), and Local Development Approach (LDA). (See article by Toshihiro Yogo in Regional Development Dialogue, Vol. 6, No.1, Spring - 1985). The RRDA is based on the "Growth Pole" strategy which is aimed at promotion of investments in economic infrastructure and setting up of industrial complexes. The market is regarded as the actual agency to accomplish development. Under the CRDA an increase in gross regional product and a decrease in regional inequalities are the major goals and the government is expected to play a major role in achieving these goals. The LDA is characterized by the theme of "growth with equity" and the major goal of the approach is to reduce disparities in terms of attainment of basic human needs at regional level.

Regional Planning Strategies in Sri Lanka

When applying Yogo's classification on regional development approaches to the Sri Lankan context, some difficulties arise especially due to changes in political regimes that were associated with different political ideologies. However, it is clear that there was no remarkable difference between the colonial era and the period from independence to 1956, in terms of regional development strategies. In other words, during this long period no special attention was paid to develop lagging areas or to arrest the growing polarization trends of economic activities in the Western Province, except for peasant colonization schemes based on Dry Zone area development.

Some characteristics of the RRDA could be identified during the period from 1956 to 1970. The Ten Year Plan (1959-1969) emphasized the necessity of reduction of regional inequalities through the improvement of infrastructural facilities in interior lagging areas. The industrial policy of this Plan, based on state owned heavy industries and private owned medium and small scale industries, was to some extent aimed at utilization of resources at regional level ensuring the links between agricultural and industrial sectors. Although the plan was not implemented due to political changes, under the new political regime between 1960 and 1965 industrial deconcentration, land development, irrigation and peasant colonization continued to dominate government's priorities, aiming at utilization of resources available at regional level. The government which won the election 1965 emphasized the necessity of the modernization of agriculture through application of high yeilding varieties and chemical fertilizers. In the case of industrial development, several fiscal incentives were introduced in order to provide inducements to the private sector. However, they were not characterized by the components which could lead to disperse industrial activities to the lagging regions.

The period from 1970 onwards exhibits some of the components of the CRDA and more or less the characteristics of the LDA. The socio-economic policies of the government, that came into power in 1970, at the outset stressed the need of regional planning efforts towards spatially balanced development in the country. In the case of regional planning, both institutional and administrative reforms that were based on principles such as people's involvement in the decision making process at local level and decentralization of political and administrative powers were more or less similar to the components of the LDA' In other words, the major theme of the regional planning efforts after 1970 was to ensure the basic human needs attainment of the people through maximum utilization of local resources with people's participation. To ensure the involvement of local level institutions in decision-making and plan implementation the People's Committee's (PCs), the Divisional Development Councils, (DDCs), the Agricultural Productivity Committees (APCs), and the District Development Councils (1980 onwards) were set up. The establishment of the Decentralized Budget System (DCB), the District Political Authorities and the District Ministry System (1978 onwards) was aimed at institutional changes towards administrative decentralization. The Integrated Rural Development Programmes (IRDPs), and the Village Re-awakening Movement (VRM) were focussed mainly on community development which lead to enhance the provision of basic needs such as education, health and safe water etc. at local level.

The Impact of the LDA on Regional Disparities

In order to examine the relative changes in the regional imbalances in development, some selected economic and social aspects were considered namely urbanization level, educational attainments, health improvements, nutritional achievements and housing conditions. To quantify the degree of performances in each area several indicators were used as described below. These included the urbanization rate and urban-rural ratio for urbanization level; literacy rate and percentage of people who passed the GCE (O/L) and above for educational attainments; infant mortality rate and maternal mortality rate for health improvements; percentage of children who had evidence of chronic undernutrition (stunting) and percent of people who received Food Stamps for nutritional achievements; and permanent housing units as a percentage of total housing units, percent of housing units with electricity and percent of housing units with piped water facilities for housing conditions.

The following table gives Composite Disparity Indices (CDIs) for 1971 and 1981 which were calculated using the above indicators. *1

$$*1 \quad CDI = 1/n \sum_{i=1}^{n} Ii$$

Where,

Ii = index for the ith indicator

n = number of indicators

$$Ii = \frac{Ti}{To} .100$$

Where,

Ti = district indicator for ith characteristic

To = national indicator for ith characteristic

From the data in the table it could be observed that although certain changes have occured, in the overall sense they have not contributed to any significant reduction in the level of disparity. This is because the pattern of change is characterized by the fact that positive changes achieved by lagging districts are offset by similar changes in some leading districts and vice-versa. The higher ranking district of Jaffna, for instance, has recorded an increase of 14 in the index thereby increasing the level of disparity further as against an increase of 32 in the index for Moneragala, one of the lagging districts. This is also evident from the fact that the standard deviation which measures the degree of dispersion shows a small increase from 22.23 in 1971 to 23.19 in 1981

Causes for the Poor Performances of the LDA

In a broad sense, the causes for the poor performances of the LDA in terms of reducing the regional disparities of basic human needs satisfaction could be viewed from two aspects. The first relates to some national level characteristics that are associated with spatial concentration of socio-economic and demographic factors; whereas the second deals with some irrationalities and shortcomings of the regional development strategies, especially of the LDA.

Among the national level characteristics the spatial polarization of Colombo and spatial bias of national development strategies are very important. During the colonial era and the period following the gaining of political independence, the trend of polarization of Colombo has been continuing due to absence of proper regional development strategies that focussed on spatial dispersion of economic activities. In addition, the continuation of the traditional import-export structure (based on Colombo port) has also led to aggravate the polarization trend. The spatial bias of national development strategies towards the Western Province could be clearly observed during the past decades and at present. This is mainly because of the absence of a proper decentralized decision-making process and planning system on a regional basis.

Several regional level characteristics could be identified regarding the existing regional inequalities in development. They are mainly the unequal distributive pattern of industries, irrationalities of resource allocations under the DCB, institutional weaknesses of the local bodies. lack of coordination among

Composite Disparity Indices (Sri Lanka = 100)

District	CDI for 1971	CDI for 1981	Change
1. Colombo (*1)	155	153	- 2
2. Kalutara	107	112	5
3. Kandy	73	74	1
4. Matale	82	92	10
5. Nuwara Eliya	54	58	4
6. Galle	105	106	1
7. Matara	94	89	- 5
8. Hambantota	83	99	16
9. Jaffna	124	138	14
10. Mannar	83	95	15
11. Vavuniya (*2)	105	110	5
12. Batticaloa	90	95	5
13. Amparai	83	99	16
14. Trincomalee	124	131	7
15. Kurunegala	85	95	10
16. Puttalam	105	126	21
17. Anuradhapura	92	107	15
18. Polonnaruwa	86	125	39
19. Badulla	67	64	- 3
20. Moneragala	67	99	32
21. Ratnapura	71	72	1
22. Kegalle	78	84	6
Sri Lanka	100	100	-
Standard Deviation	(22.23)	(23.19)	

*(*1) including the Gampaha District.*
*(*2) including the Mullativu District*

Source: Own Calculations

departments and ministries at local level and regional bureaucracy.

Conclusion

The regional disparities that emerged during the colonial era could be viewed as the consequences of development policies that were merely based on exploitation of local resources through an export oriented plantation agricultural development. Although all successive governments after independence, continued the welfare policies aimed at upgrading the living conditions of the people, emphasis was not given to the elimination of inter-regional disparities or spatial polarization of development upto the 1970's. The decades of 1970 and 1980 were very important in the aspect of introducing local level planning based on popular participation. However, according to the findings of this study, it could be concluded that the strategies of the LDA itself were not able to achieve an appreciable reduction of inter-regional disparities related to basic human needs.

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SECURITIZATION AND NEW TREND OF THE ACQUISITION OF THE THIRD WORLD'S ASSETS

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INTRODUCTION

A growing number of Japanese companies are purchasing Third World country's U.S. dollar debts in order to swap them for local currencies needed for investments in these countries. Japanese corporations are using this, "debt to euity" conversion technique to raise capital for their subsidiaries in Third World countries. This technique enables them to exchange the discounted dollar debt for local currencies at rates considerably cheaper than would be possible by changing yen into the local currencies on the foreign exchange market. But this new method of financing, which acts as a catalyst for direct investment of Japanese firms, reflects a sweeping change in the world financial markets and causes serious problems both for the commercial banks of the developed countries, and those of the Third World countries. Commercial banks are losing their traditional intermediary roles in international finance and this, in turn, is weakening their ability to control the domestic finance of the Third World countries.

TABLE 1.

INTERNATIONAL BORROWING

(US$ billion)	1983	1984	1985	1986
Floating-rate bond issues	19.5	38.7	58.4	54.8
Other bond offerings	57.6	73.3	109.3	177.4
Syndicated loans	67.2	57.0	42.0	40.1
NIFs and other back-up facilities	9.5	28.8	46.8	26.0
TOTAL	153.8	197.3	256.5	298.3
Share of securitized forms of financing (%)	54.5	65.3	79.5	84.2

Notes:

1. January - September at annual rate.
2. Excluding merger-related standbys and renegotiations.

Source: *Financial Market Trends, 35, OECD, Nov. 1986., p.6.*

The shift of Japanese production overseas is causing serious tension in the Third World. This shift has been caused by the high yen and realized through "debt to equity" conversion.

It works like this: a U.S. investment firm finds a bank which has extended, say, a US $ 100 million loan to a debtor country and is worried that the loan may not be repaid. The bank agrees to sell its credit through the investment firm for US $ 70 million and to take a loss of US $ 30 million. The investment firm then tracks down a company which needs the currency of the debtor country to make an investment. The firm arranges for the sale of the loan to the concerned corporation (investor). The company then approaches the central bank of the debtor country and tenders the loan for, say, 89-90 percent of its local currency value. It can thereby save 10-20 percent of the foreign exchange expenditure. Through this transaction the investment firm can charge fees of 0.25-1 percent of the value of the deal. This system is also advantageous to the bank (original lender) which can get an undesirable loan off the books for most of its cash value. In practice, the technique is far more complicated, involving swap deals among many participants.

Eclipsed Bank Loans

The technique of securitization has lowered costs for fund procurement and allowed greater liquidity, and has thus drastically reduced the reliance of non-financial companies on direct bank financing. Borrowing by U.S. non-financial companies from banks, which had been their primary source until recently as 1984, amounted to only a fourth of their total fund-raising in 1986. Now the U.S. companies are securitizing anything: mortgages automobile loans and consumers loans etc., which were not placed on the market formerly and were difficult to trade.[1] Firms of European countries and Japan are following this trend. Thus in international markets, securitized loans now account for 80 percent of the whole new fund supply, a large increase from approximately 50 percent in the mid-1970s. Syndicated bank loans have decreased not only as a share of finance but also in real dollar terms. The weight of Euro-bond and Euro-commercial paper has increased in international markets and the Euro capital market depends totally on these two. As a result of the extraordinary expansion of these two forms of financing, the volume of international financing has increased by 28 percent in 1986 from the previous year. (See Table 1)[2]

But these trends only reflect, factually, the severe decline of commercial banking in financial markets. The performance of the markets seems to be the results of refinancing older and more expensive loans. The volume of early repayments of outstanding bonds has soared to US $ 38 billion (annually) in 1986, as compared with US $ 19 billion in the previous year.

Increased Debt-to-Capital Ratio

Today, the major U.S. companies are finding more advantageous financing sources not inside but outside of U.S. boundaries, so they prefer to hold debt in foreign currencies, even if they do not operate overseas, and to swap them for other dollar debts. Interest and currency swapping afford them the cheapest vehicles. Such swapping has become a permanent fixture of firms' financing schedules. Big companies are tending more and more to operate independently from banks by transfering from one new financial item to another.

The situation, however, is still difficult to assess, because financial items do not have an indefinite market. Placement of bonds by final investors may be difficult, resulting in a large overhang of unsold paper. And for banks there seems to be little alternative but to continue to be the heavy tankers of securities because of the weak loan demand by high-quality borrowers.

The availability of a wide range of financial tools is causing a shift in priorities by companies financial strategists. Instead of locking in long term rates, many companies are continuously searching for better loan opportunities, and swapping old obligations for new ones. In this situation, many banks are being forced to sell off their loans to other investors. In the past, banks often sold off their loans when they were bumping up against their legal lending limits. Now they plan from the begining to sell loans to other investors who can accept them for various reasons. Such downstream financing makes a lot of prominent companies able to finance below LIBOR (the London inter-bank rate on dollar borrowings). As a result, the aggregate debt-to-equity ratio of corporate America has become 3-to-1, a big increase from the 2-to-1 ratio that held for most of the 1960s, though lower than Japan's ratio of 6-to-1. The signs of speculative excess are clearly there. Nevertheless, big business is becoming increasingly comfortable with using debt to put a higher market value on their assests. This fat money, though, has deprived the commercial banks of their proud, old line status in the money market. Chase Manhattan Bank, the third largest in the United States, has a lower value in the stock market than Toys "R" US, a toy Company.[3]

Bad Debt to the Third World

One indication that banks are being bypassed in the financial process is that non-interest income now accounts for as much as 30 percent of the earnings of the U.S. largest banks, and is likely to keep rising.[4]

The most immediate problem for U.S. banks, which are now forced to find the path to survival in business other than those essential to commercial banks, is the volume of shaky loans to the Third World. More and more banks are refusing to lend new money to debtor countries. They would rather seek a more far-reaching solution, even if this means writing down the value of their loans. In effect, "debt-to-equity swap" is one example for solution.

Shearson Lehman, which is alleged to have pioneered various techniques for repacking these loans, has said that the secondary market of this kind reached US $ 5 billion in trading volume in 1986 and could double in 1987.[5] Although the market is small compared with estimated total debts, roughly US $ 1 trillion, these transactions have surely inspired many Japanese companies which hope to increase their investments in the Third World.

TABLE 2

DEBT FIRESALE: PRICES FOR DEVELOPING COUNTRIES' DEBT AS A PERCENTAGE OF ITS FACE VALUE

	Dec. 1986	June 1986	Jan. 1986
Argentina	62 - 66	63 - 67	62 - 66
Brazil	74 - 77	73 - 76	75 - 81
Chile	65 - 68	64 - 67	65 - 69
Colombia	–	80 - 82	82 - 84
Ecuador	63 - 65	63 - 66	68 - 71
Mexico	54 - 57	55 - 59	69 - 73
Peru	16 - 19	17 - 23	25 - 30
Philippines	72 - 76	n.a.	n.a.
Poland	41 - 43.5	43 - 46	50 - 53
Romania	86 - 89	89 - 92	91 - 94
Venezuela	72 - 74	75 - 78	80 - 82
Yugoslavia	77 - 81	77 - 79	78 - 81

Source: *Shearson Lehman Brothers, cited from Far Eastern Economic Review. 29 January, 1987, p. 43.*

Japanese Companies, the Largest Buyers of the Third World Debt

A growing number of Japanese companies are now eager to buy up the U.S. dollar debts of the Third World in order to swap them for local currencies needed for various investment projects. Nissan Motors was the first participant in these transactions. By using the debt-to-equity swap technique, it boosted capital in its Mexican subsidiary. This method was also followed by a Japan-Mexico hotel joint-venture company. In the Philippines, Kawasaki Steel,[6] Japan Air Lines (JAL), and Kao (a soap manufacturer) are now trying to finance projects in the same way.[7]

This method of financing is indeed acting as a catalyst for direct investment by Japanese companies. Along with Chile, the Philippines and Mexico are the only countries so far to have officially endorsed the repurchase of U.S. dollar debts, though acceptance of this method seems to be spreading to other Third World countries. Only the reselling of U.S. dollar debts (without converting them into local currencies) is widely done as shown in Table 2.

Japanese banks, which have hesitated to join the queue of loan-sellers, are now said to have begun to reconsider their hands-off policy. Some Japanese banks, such as Sumitomo and the Industial Bank of Japan (IJB) are attempting to gain fee business by acting as intermediaries in this market. Though these transaction do not involve the bank's own loan selling, they may soon begin to. In November 1986, the IJB brokered a debt-to-equity swap on behalf of the Japan-Mexico Hotel Investment Co. (Jamex), a group of 54 Japanese companies with a 49 percent stake in Hotel Nikko Mexico in Mexico City. Jamex bought Mexican debt worth US $ 9million at a reported discount of around 60 percent and converted it into Mexican pesos at 80-90 percent of the market rate. Sumitomo Bank offered to arrange the purchase of some of the Philippines' U.S. dollar debt on behalf of a Scandinavian company in November 1986.[8]

Among U.S. investment banks, Shearson Lehman and Citicorp International have been actively encouraging Japanese companies to tap the debt market for their investment finance. When both banks got the news that JAL was planning to refurbish the Manila Garden Hotel, owned mostly by JAL, they made rapid proposals for debt conversion into Philippine pesos. JAL went with Citicorp, and in December 1986 bought US $ 1 million worth of Philippine debt for US $ 700,000. The Philippine government was assumed to have charged 5-10 percent for stamping this deal. So the final cost for JAL, after paying fees to Citicorp and charges to the Philippine government, was estimated to be US $ 800,000.[9]

In November 1986, Kawasaki Steel Corp. similarly raised US $ 1.2 million in a deal arranged by Shearson Lehman for a 30 percent discount. It got pesos at 95 percent of the face value to boost its wholly owned Phillippine Sinter Corp. Kao Corp. in attempting to acquire US $ 17 million worth of Philippine debt for an expansion of its coconut oil plant in Mindanao and for a new shampoo factory in Manila.[10] These big Japanese conversions of Philippine debt into equity may largely affect the debt market, and many other Japanese companies may soon follow suit. The Central Bank of the Philippines is reported to have received a total of 42 applications from foreign companies seeking to convert debt worth US $ 220 million. Of those, 15, worth US $ 33 million, have been approved.[11]

Concluding Remarks

During the past three years (1984-86), Japanese firms have sunk an estimated US $ 100 billion worth of surplus funds into the New York bond market, realizing heavy capital gains as U.S. bond prices have risen. But if depreciation of the U.S. dollar continues and if the prospect of further decline in New York interest rates disappears, the Japanese investors will surely sell off their New York bonds in great quantities, resulting in further depreciation of the U.S. dollar. The experience of March 1987 when the yen went up to US$1 =Y 140s shows the strong possibility of such a situation occuring.[12]

A time will come when, in accordance with the MITI plea for stepped up investment into offshore production, some of this money will be diverted to activities in the Third World, which in turn will force the U.S. dollar to be sold heavily. Thus the only resort left for those with speculative money of both the United States and Japan may be the investment by Japanese companies in the Third World, because out-sourcing the manufactured goods is rapidly generalizing and commercial banks are losing weight in their traditional function. Selling the bad loans and short-term circulation of their assets are required for banks to get out of the pressure by depreciation of U.S. dollars and lowering bond price. Thus debt-to-equity has become common.

But needless to say, this type of transaction means that the debtor countries are forced to sell their domestic assets at much discounted rates to the powerful multi-national companies, thereby limiting their control to the MNCs.

NOTES:

1. "Global Financial Change," *World Financial Market*, Morgan Guaranty Trust Company of New York, December '86, p.1.
2. "Highlights: International Financial Markets," *Financial Market Trends, 35*, OECD, November 1986, p.5.
3. "Another Great Year- for Defaults," *Business Week*, January 12, 1987, p.76.
4. *Business Week*, January 12, 1987, *op.cit.*, p.77.
5. "New Profit from Old Losses," *Far Eastern Economic Review*, 29 January 1987, p.43.
6. *Asahi Shimbun* (in Japanese), January 16, 1987.
7. *Sankei* (in Japanese), September 14, 1986.
8. *Far Eastern Economic Review*, 29 January 1987, *op.cit.*, p.42.
9. *ibid.*, p.43.
10. *Nihon Keizai Shimbun* (in Japanese), October 22, 1986.
11. *Nihon Keizai Shimbun*, December 1, 1986.
12. *Nihon Keizai Shimbun*, March 28, 1987.

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DEFINITIONS

Security:

1. Any income-yielding document that can be traded, as on a stock exchange. Securities may carry fixed interest, as in the case of debentures, bonds, preference shares, and guilt - edged securities, or variable interest as with ordinary shares; they may be redeemable or irredeemable. The term is also used in reference to such commercial documents as bills of exchange and convertible assurance policies.
2. Policies pledged as collateral for a loan by a borrower, or the document concerned with such collateral.

Securitization:

The term is most often used narrowly to mean the process by which traditional bank assets, mainly loans or mortgages, are converted into negotiable securities. More broadly, the term refers to the development of markets for a variety of new negotiable instruments.

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