

THE PROSPECTS OF CREDIT AGENCIES IN EMPLOYMENT GENERATION

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Introduction

The problem of unemployment in Sri Lanka has grown in size particularly after 1983. Estimates show that over the period 1981-86, the total workforce has grown from 5.75 mn to 6.37 mn or at an average of 124,000 per annum. By contrast, net employment creation has grown at something less than 90,000 per annum and hence the open unemployment has increased from 14.7 percent in 1981 to 16.2 percent in 1986 (Irvin, 1986). Underemployment is also serious (Central Bank, 1984). Nearly 75 percent of the unemployed population of the country are concentrated in the rural sector. Sri Lanka has relied heavily on its agricultural sector for provision of employment to its growing labour force. Agricultural sector provides direct employment to nearly 45 to 50 percent of the workforce. However, during the past four decades, agricultural employment did not increase much. The average rate of growth of employment in agriculture was only 1.3 percent per annum as against the labour force growth at about 2.3 percent per annum (Korale, 1986). The modern industrial sector which is capital intensive and heavily dependent on imports for inputs failed to employ the large volume of unabsorbed rural labour resulting from the above disparity of growth rates. In order to expand the employment opportunities in the rural sector, the attention has been focused on the need to promote new investment and intensified use of existing assets as well as the increase in the productivity of their assets. It has also been recognized that one of the major constraints facing the achievement of this task is the absence of a smooth flow of capital in the form of institutional credit to the unemployed rural population. The majority of the unemployed population in the rural sector have a limited access to the country's natural resources. According to the Census of Agriculture, 1982, 11 percent of the operators in the small holdings sector had no land and 39

percent were almost landless having only homegardens averaging 0.6 acres. Furthermore, these marginal and small farmers often have little access to technology and services that could help improve their productivity. A person with extremely thin economic base cannot yield a larger share of return for his work. If he can gradually build up his asset-base he can command a better share for his work. Credit is a financial asset that creates entitlement to resources. The more credit one can receive, the more resources he can command. Access to credit, therefore, is an important component for on-farm and off-farm employment and for the development of microenterprises. Despite the importance of credit in employment generation, experience shows that the development of an effective credit delivery system for dealing with large number of small farmers and entrepreneurs has not been an easy task in Sri Lanka.

Development of Rural Credit Policies in Sri Lanka

(a) Short-term Credit

In Sri Lanka, traditionally credit has been provided to the rural sector mainly by non-institutional sources at very high interest rates. The banking system was involved in the provision of rural credit for the first time by implementing the New Agricultural Credit Scheme (NACS) in 1967 under which the People's Bank attempted to meet the needs of the farmers in the food crop sector through the co-operatives. Paddy and subsidiary crop farmers were provided with cultivation loans at a very concessionary rates of interest 9 percent per annum for a duration of 240 days. The People's Bank which implemented this scheme received re-finance from the Central Bank of Sri Lanka at 1 1/2 percent per annum and was also given a credit guarantee of 75 percent of defaulted payments.

The NACS was replaced by the Comprehensive Rural Credit Scheme (CRCS) in 1973. At this stage, Bank of Ceylon also

commenced lending for agriculture through the Agrarian Service Centre branches. Though this scheme was intended to be an improvement over the previous scheme, enabling the banks to extend credit to cover short-term needs other than cultivation (i.e. consumption) in practice, the credit was provided only for cultivation purpose. Immediately after the change of government in 1977, there was a certain amount of liberalization of credit to rural sector which however, resulted in heavy default rates and the banks were compelled to be more restrictive in credit disbursement.

With a view to correcting the shortcomings observed in the implementation of the CRCS, the New Comprehensive Rural Credit Scheme (NCRCS) was introduced in 1986. This was designed to reduce both the lending costs and the borrowing costs by lowering transaction costs involved in lending operations.

(b) Medium and Long Term Credit

Until the late 1970s, rural credit in Sri Lanka was confined only to the supply of short-term cultivation loans and there was no credit scheme implemented by the banking system to meet the investment credit requirements of the rural sector, since the late 1970s a large number of medium and long term credit schemes have been introduced to assist on-farm and off-farm projects in the rural sector. They included the projects in agricultural, fisheries, rural industries, farm machinery, animal husbandry and many other self employment activities. As at the end of 1988, there were 23 such schemes and the Central Bank had allocated Rs. 72.7 million from its medium and Long-Term credit fund to provide re-finance.

The Performance of the Rural Credit Programme

Despite considerable expansion of banking facilities, Concessional Credit Schemes and Central Bank re-finance and guaran-

tees, the rural credit programmes that have been implemented in Sri Lanka during the last two decades have failed to make a significant impact on rural employment. According to the estimates of the Department of National Planning, the ratio of agricultural credit to agricultural GDP fell from 12.2 percent in 1982 to 8.6 percent in 1985. While credit to all sectors recorded a five-fold increase between 1977 and 1985, the share of agricultural credit was only 11 percent of total commercial lending. Further, per capita agricultural credit to the rural sector under the Comprehensive Rural Credit Schemes declined in real terms from Rs. 10.34 in 1974 to Rs. 3.92 in 1988.

The data clearly show that the institutional sources have played an inadequate role in the provision of rural credit in Sri Lanka. The Consumer Finances survey 1981/82 conducted by the Central Bank of Sri Lanka revealed that 60 percent of the credit needs of the rural sector were provided by the informal sources, i.e. friends, relatives and money lenders. According to this survey, 52 percent of the number and 20 percent of the value of loans serviced in the rural sector were obtained from relatives and friends normally interest free, but the borrowers led to offer their services or effect in kind. Further, 27.5 percent of the number of loans and 20 percent of the value of loans were obtained from the money lenders at exorbitant rates of interest. The survey further reported that 52 percent of the farmers had accounted for only 20 percent of the value of loans given to the rural sector. This implies that the majority of farmers who are poor and occupying small and marginal holdings obtain small loans for cultivation from non-institutional sources.

As De Silva (1988) observes the institutional sources have not only failed to respond adequately in quantitative terms to the needs of the rural sector, but also have largely confined their efforts to servicing the credit needs of larger farmers particularly in areas coming under the major irrigation schemes. Over 65 percent of the cultivation loans reached farmers whose holdings exceeded 2 acres in size while the farmers with less than one acre of land received less attention from the credit institutions.

Factors Attributable to the Poor Performance of Institutional Credit

The experience of rural credit in Sri Lanka over the last two decades shows that the provision of credit at subsidized rates of interest with credit guarantee cover against possible risks has not helped the credit institutions to achieve a major break. The commercial banks lack the experience and expertise in rural credit compared to its availability in the case of commercial lending. The bank officials who have been trained in normal commercial banking activity usually lack orientation and experience to deal with the specific types of development projects in the rural sector. An adequate number of trained field staff is necessary for effective monitoring and supervision of credit schemes in the rural sector. It has been reported that when the NCRCS was implemented in 1986, each participating financial institution was required to recruit sufficient field staff to ensure ratio of one field supervisor to 500 farmers within a period of 2 years. The two leading state banks however did not meet this target (Central Bank of Sri Lanka, 1989). It appears that under the present rate of default and interest rates, the banks would find it uneconomical to recruit and maintain a large army of such officials.

High incidence of default has hindered accessibility of farmers to institutional sources of credit. The banking sector has granted Rs. 1,778 million for cultivation purposes between 1967 and 1985 of which only Rs. 1,040 million or nearly 59 percent had been recovered at the end of 1985. When credit recovery rates are poor, sometimes as low as 25 percent in bad years, the cost of rural credit to the institutional lenders is high and they may incur losses. According to the estimates of the banks, they should recover well over 90 percent of the loans granted on a season, to break-even in their lending for crop cultivation. Thus, the poor recovery rates compel banks to place relatively low priority on rural credit. The poor recovery creates a mass of delinquent borrowers who are not eligible to obtain further assistance from the institutional sources. This would further aggravate the situation as those who have been

refused by the institutional sources seek out private money lenders for their subsequent credit needs.

Apart from the reluctance of the banks to engage in rural lending, there are other factors which discourage small farmers and unemployed from borrowing from institutional sources despite the low interests charged. The very high transaction cost which farmer has to incur to obtain a small loan frequently hinders small farmers accessibility to institutional sources of credit. The main components of transaction cost are the costs of transportation, and meals when travelling to the office, fees and stamp duties, crop insurance premia and the value of the time. A recent study conducted by the FAO reported that in the Anuradhapura District, a cultivation loan of Rs. 2,500 granted at 9 percent per annum had an effective interest rate of 34.6 percent per annum after transaction costs were added (Central Bank of Sri Lanka, 1988). There are other farmers who abstain from borrowing from credit institutions due to their lack of capacity to repay the loans, and there are those who fear risks of litigation in the event of default. The capacity to repay diminishes due to number of factors such as small sized land holdings, lack of an assured supply of irrigation water and unfavourable terms of trade between purchased inputs and marketed products (Senanayake, 1984).

Another factor that has hindered the accessibility of the poor to the formal credit institutions is their insistence on sound collateral against the loans they provide. Owing to the high rate of default in cultivation loans the credit institutions show great reluctance to lend to the farmers in the absence of clear title to the land they cultivate.

In the case of Medium and Long Term Credit Schemes, the absorption of credit has been very slow. At the end of 1987, the Central Bank was operating 23 Credit Schemes under which credit was provided at an interest rate of 12.5 percent. Many of these credit schemes at the subsidised interest rates have remained underutilised or unutilized. For example, under the Sri Lanka/ADB Livestock Development Project, refinance funds amounting to Rs. 68.2

million had been allocated in March 1986. However, only Rs. 1.14 million had been utilized until the end of 1988. The lack of awareness by the prospective borrowers and the lack of interest by bank officials are some of the major factors responsible for the poor absorption rate of medium and long term credit funds. The insistence by banks on stringent security and the lack of co-operation of other relevant agencies and the high transaction costs also discourage the prospective borrowers. The assistance from other relevant agencies is essential for the successful implementation of credit schemes in the rural sector. For example, in the case of livestock development project, timely availability of service of veterinary surgeon is very important in recommending suitable animals and assisting borrowers with necessary extension services. This co-operation has been inadequate and the banks too were unable to co-ordinate with them satisfactorily (Attanayake, 1987). A recent survey conducted by the Central Bank to examine the reasons for low utilization of credit funds under livestock credit scheme for dairy cattle identified the following factors:

- (a) Inadequate supply and high price of animal feed,
- (b) Lack of high quality dairy cows,
- (c) Poor milk prices in project areas,
- (d) Inadequate veterinary and extension services to farmers (Central Bank of Sri Lanka, 1989)

This clearly suggests that apart from financial resources there are other structural and economic constraints to promote investment activity in the rural sector.

Strategies to Promote Rural Credit

Lending to the poor requires different strategies than mere political and bureaucratic directives to lend to the poor. Due to specific characteristics prevailing in the rural sector, the strategies to be adopted by the credit institutions should also be of a specific nature. Unconventional methods of lending and recoveries have to be adopted in order to make a significant impact on the rural employment.

(a) Production - oriented Lending

One of the major weaknesses of the credit agencies engaged in rural lending is their security - oriented approach. It is an attitude inherited from the traditional commercial banks practice. In normal practice the security for the loan rather than the project to be financed from the loan, is the most important consideration. However, in the rural sector, the majority of the unemployed population are not in a position to offer a good collateral. In financing projects designed for unemployed and small farmers, the only security they could offer is the expected income of the project. Therefore, the lending and recovery should be related to the expected flow of income from the project. For project - oriented lending the bank staff must be conversant with the investment appraisal techniques and project reports should be properly prepared to estimate the income stream and the repayment capacity of the borrower. Evaluation of a project is more complex than evaluating the security offered (De Silva, 1988).

(b) Group Lending

It may be possible for the lending institutions to organize small farmers and entrepreneurs into informal groups and lend to the group. Such producer groups should be encouraged to borrow as an entity and since early 1960s, the approaches by them to promote thrift and credit among rural people were basically traditional methods used elsewhere. Various types of groups in savings and credit have remained outside the sphere of formal banking institutions. The banks so far have not made any effort either to form such groups or to promote group responsibility in borrowing. Apart from the fact that it is a more effective method of reaching the rural poor, there are other advantages in group lending (Attanayake, 1988). These are as follows:

- (a) Group consciousness improves the security of lending by infusing the idea that repayment of loans is a responsibility of the entire group rather than the individual borrower,

(b) Supervision of credit is relatively convenient because a part of supervision can be entrusted to the group itself.

(c) Imparting knowledge and training to a group is relatively easy rather than to individual borrowers

In the absence of any significant linkages between the banking system and the rural low income groups, there has been an emergence of a large number of non-governmental organisations (NGOs) in the recent past. Although most of them are involved in religious and cultural development activities, community development and research etc; there are some NGOs such as Sarvodaya, Thrift and Credit Co-operatives (TCCS) and Redd Barna which are extensively engaged in organising self-help groups in income generating activities. Credit may be channelled through these intermediaries who can disburse funds more effectively than institutional sources. However, the existing linkages between these NGOs and the formal credit institutions are very weak. The only institution that has established some links with the banking system is TCCS.

(d) Flexibility in Credit Policy

The success of credit programmes rests very largely on the capacity developed by the disbursing agency to be flexible in its credit policies and its ability to judge credit worthiness (Sandaratne, 1986). The institutions disbursing credit should be in a position to determine the criteria for lending and bear the risks of such lending. The government agencies should provide only the broad guidelines and the credit disbursing agencies should have the flexibility to select customers, to penalise wilful defaulters etc. (Fernando, 1982). The forced-lending would be damaging to the development of an intimate relationship between the banker and the customer. One reason for the failure of the commercial banks to achieve a complete capability to supervise credit disbursements and improve their credit supervision is that at times governments have laid down policies on who should be given credit rather than having left it to the banks to determine the credit worthiness of borrowers.

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