



The conditions of the rural peasantry in much of Asia has been tellingly described as that of being "up to the neck in water". A crop failure or sudden illness could result in most of the peasantry sinking. The village money-lender, who is usually pictured as usurious; the boutique keeper who provides daily provisions at perhaps very high hidden interest charges; the landlord who exacts commitments and conditions from his indebted tenants; they are all essential in this context where the peasant farmers have no other means of obtaining their daily consumption needs, cultivation costs and occasional unexpected expenditures.

A livelihood derived by the cultivation of a small holding which hardly gives a subsistence income is indeed a poor base from which most rural farmers can hope to move out of their deprived circumstances. On the one hand, they do not have the capital required to adopt new practices and the necessary inputs. Output in this 'traditional' sector has become essentially a function of land and labour; and very rarely is there an accumulation of capital as in the 'modern' or 'industrial' sector. On the other hand, the uncertainty of untried methods leads to a rational aversion of risks and almost a resistance to change and a continuation of the more certain but less productive methods. So poverty breeds poverty in rural areas.

# RURAL CREDIT

## Need, Availability, Issues, Directions

Credit to the rural sector is a complex issue. It is quite a different proposition to that of lending to large-scale industrial or commercial enterprises or large-scale agriculture. Large enterprises have adequate collateral, their economic viability is easily determined, they can be relied on to use the funds in a profitable manner, pay their interest commitments and return the capital lent. Further, commercial banks have had years of experience in lending to such enterprises and the administrative costs of such lending are low as they deal with a small number of large borrowers.

On the other hand, the crying need to provide credit to the smaller farmers is counterbalanced by the

complex issue of whether credit should be given to farmers with less than viable units. The argument runs that credit given to these farmers cannot be recovered since, with their very low incomes, they are likely to use the additional output too for consumption. The determination of who are viable farmers poses considerable difficulties. The viability of a farm depends not only on its physical size but soil fertility, availability of irrigation, cropping patterns and rental arrangements. Once a viable size is determined by regions in the country, the exclusion of non-viable farms may result in most farmers being outside the umbrella of institutional credit as a large proportion of farms is small.

And does this not answer the much asked question — Why has rural growth been slow and comparatively rural poverty been increasing? Most of the low income groups in the rural areas depend heavily on agriculture for their livelihood. They generally must contend with a limited access to natural resources. More frequently they suffer because they have little access to technology and services that could help raise their productivity. In many cases vested interests operate to ensure not only that the benefits of productive activity are distributed inequitably, but that the poor are denied access to inputs, services and organisations which would allow them to increase their productivity.

Thus the rural sector, is characterised by a large number of small farmers with agricultural holdings often too small to generate a marketable surplus or a livelihood much above subsistence. The predominant role played by informal lenders like money-lenders, boutique keepers, traders, wholesale procurers of produce and landlords; the lack of a well-developed institutional set-up to channel credit and other inputs; the lack of effective farmer organizations; the procedural-bound nature of government and other institutional sources of inputs are among the other characteristics of this sector which render the provision of adequate institutional credit at reasonable costs and in time a complex issue.

### Informal Lending

The rural sector of Sri Lanka has traditionally depended on informal non-institutional sources for its needs of credit. Friends, relatives and landlords who give credit to farmers at times of need may sometimes lend free of interest or at a low rate of interest. This may be because a reciprocity is assumed with the borrower perhaps lending at other times or the borrower helping in non-financial ways such as by assisting in farming operations or in the domestic chores of the creditor. Lending on a personal basis may have no reciprocity but be part of either the social and kinship relations in the village or be a facet of the patron-client relations which characterize traditional village society.

For instance, the interest rate structure that was revealed in the rural sector when the Central Bank conducted its survey of Rural Credit and Indebtedness in 1969 is most interesting. While usurious rates of interest of 175 percent per annum or more were charged, such rates applied to less than a quarter of borrowings and were mainly for loans of less than Rs. 5,000. A very large portion of loans was free of interest. About 36 per cent of loans was at zero interest and nearly 50 percent of interest-free loans was household debts below Rs. 2,000. These facts bespeak of a highly personalised informal rural credit market. However, some loans

which are considered interest-free may have had an element of hidden interest when they were part of a transaction in kind.

Informal or non-institutional credit sources have several advantages to the villager and small farmer. Little or no collateral is asked for and repayments can be adjusted to times convenient to the borrower. He need not go through elaborate procedures and form filling. Informal credit sources give credit for consumption purposes like purchase of consumer goods and for expenditure at times of personal contingencies. Informal credit is largely credit 'with no questions asked'.

The convenience, flexibility and accessibility of informal credit sources account for the greater dependence on them in the rural sector. Despite efforts to increase institutional lending, owing to these advantages, all surveys of rural credit and indebtedness disclose the predominance of non-institutional sources of credit.

### Why Credit

A fundamental question must be posed before the discussion of the sources of credit, the programmes devised to serve this sector and the problems encountered by institutional credit. Why credit to the rural sector?

Credit is often needed for normal consumption requirements of the rural sector owing to the low levels of income, the lack of savings and the discontinuous nature of income flows in an agricultural economy. Often farmers borrow continuously for their living expenses and repay their debts at harvest time. Unexpected expenditure on illnesses, religious festivities, family occasions like marriages as well as disasters like crop failure tend to increase indebtedness as no surpluses from current income are generally available for such expenses. Indebtedness, with its consequent interest costs, could itself be a factor in increasing indebtedness.

Credit for agriculture has become more important in recent years

owing to new technological developments which have increased production costs several-fold. The high yielding varieties which generate yields several times those of traditional varieties require the use of costly inputs like fertilizers, insecticides and weedicides. Farm machinery and equipment like tractors and sprayers require medium-term capital, while long-term capital requirements for irrigational improvements like tube wells are other needs. Today, therefore, one could say that the improvement of agricultural practices is one of the most pressing modern reasons for increased credit to the rural sector which is predominantly a small farm sector. But the question why rural credit goes far deeper than that — it takes us to the crux of the entire problem of indebtedness itself.

### Degrees of Indebtedness

There is no available measure of the indebtedness that prevailed in Sri Lankan village communities before the introduction of the plantation economy and the encroaches of commercialism. However, from available qualitative descriptions we could assume that the village level subsistence economy, based largely on barter transactions and exchange, would have had a certain degree of indebtedness tied to the village socio-economic structure. The integration of Sri Lanka as a dependent part of a world economy and the consequent spread of commercial links throughout the country led to the predominance of the plantation sector and the disruption of the traditional rural economy. Parallel to the disruption of the hitherto largely self-sufficient subsistence economy occurred the growth of indebtedness.

The traditional socio-economic structure in Sri Lanka provided a mutual set of supporting relations for individuals within the system and a considerable amount of economic activities were based on exchange governed by this matrix of mutual obligations. With the breakdown of this structure, due to increased commercialisation, money transactions entered the scene and the earlier obligations were now performed under sanctions of law

administered by officials. The growth of commercialism combined with very small-holdings and an increase in population subsequently gave rise to the growing problem of indebtedness in the Sri Lankan countryside.

The level of rural indebtedness can be seen in the context of the small farmer and the land tenure systems. The average paddy holding in Sri Lanka is less than two acres and according to calculations, made by Yogaratnam and Schickle, most paddy farms under two acres tend to be non-viable in that they could not meet incomes for family needs. (See box at right). There is a tendency for farm sizes in certain areas to grow whilst as a parallel feature other farms get smaller. This process gives rise to the twin problems of a tendency to landlordism as well as fragmentation and even worse the growth of landless labourers. This fact explains one reason why the farmer is driven to an increasing debt spiral as indicated by several studies.

Several rural economic surveys undertaken between 1936 and 1948 disclosed a high level of indebtedness and high interest rates prevailing in these areas. Another survey undertaken in 1950/51 when Korean boom conditions were prevailing indicated an improvement in the rural indebtedness situation. But the first systematic collection of data on credit conditions in the rural sector was the Survey of Rural Indebtedness undertaken by the Department of Census and Statistics in 1957.

#### EARLY CONDITIONS OF RURAL INDEBTEDNESS

Information of credit conditions in the rural sector prior to 1957, when the first National Survey of Rural Indebtedness was undertaken is very scanty. Several rural economic surveys undertaken between 1936-1948 disclose a high level of indebtedness and high interest rates. The proportion of indebted families was very high in most districts surveyed. As much as 75 percent of the families were indebted in one district. The average indebtedness ranged between about 30 to 90 percent of average annual income and a very high proportion of families had an excess of expenditure over incomes. Contrary to the general impression that a high proportion of loans in the rural sector is for unproductive purposes, a very large proportion was for agricultural expenditure.

#### SIZE OF PADDY LAND HOLDINGS, SRI LANKA

The majority of producers in the agricultural sector are those who have small holdings. Thus according to the Census of Agriculture carried out in 1962, as much as 95.8 percent of holdings in the entire agricultural sector was less than 10 acres. The small-scale of operation is most evident in paddy production in comparison with that of plantation crops. Data collected by the Department of Agrarian Services in 1970 indicated that in the case of paddy two-thirds of producers had holdings of less than 1 acre but they operated only about one-fifth of the total land under paddy. The average size of a cultivated plot of these two-thirds of producers was only about half an acre. Further, according to the same source, three-fourths of paddy land in the island were in holdings of less than 5 acres. These figures are confirmed by other district level studies. For instance an Agrarian Research and Training Institute study conducted in Hambantota in 1974 indicated that the average extent of highland operated by paddy

cultivators was 1.9 acres while in two other districts studied (namely, Polonnaruwa and Kandy) it was found to be 2.2 and 2.1 acres respectively.

Further, the Paddy Lands Register of 1970 gave the number of tenant cultivators as 318,459 cultivating 308,459 acres and owned by 239,411 land owners. The landlords apparently held only small parcels of land. Of the 800,000 owners of paddy land only 3.6 percent had more than 5 acres.

Most recent reports indicate that there were 450,929 tenant cultivators who worked paddy fields of half an acre each; while there were about 7,000 tenant cultivators who worked fields of 10 acres and over. (The Government is introducing legislation to restrict the extent a tenant cultivator could work to five acres, because it was felt that anything over five acres was too large for a single cultivator to make maximum use of for paddy cultivation).

(See box below) This survey disclosed that 54 percent of all rural families and 60 percent of agricultural families were in debt. For the first time information had been obtained on the sources of credit and it was found that less than 8 percent of credit was from institutional sources. In 1969 the Central Bank conducted a Survey of Rural Credit and Indebtedness, but this survey was carried out under changed circumstances as the People's Bank had been established in 1961 with the specific objective of serving the credit needs of the rural sector. The sources of credit for farmers indicates an interesting profile, as seen in Table I (on page 6), derived from the Rural Indebtedness Surveys of 1957 and 1969.

It is seen that a large percentage of the credit disbursements are from non-institutional sources, the most important source being friends and relations, an outcome of the extended family system in Sri Lanka. Further, there is considerable evidence that a high percentage of funds borrowed from these sources are free of interest as these transactions arise from a web of mutual family and other obligations and not from impersonalised business transactions. An important source of credit of a semi-professional nature were those of money lenders.

#### Government-sponsored Credit Schemes

With the recognition of indebtedness as a problem, several Government-sponsored institutions have attempted to intervene to alleviate the condition of the peasant. The most significant of these has been the Co-operative Credit institutions which have been in existence since 1912. The Government began first using this scheme for institutional credit for peasant farmers from 1947 whereby credit was channelled to farmers and administered on an islandwide basis by the Land Commissioner. During the five-year period 1952 to 1957 this scheme of channelling credit was carried out by the Department of Food Production. During this early period disbursement of credit grew steadily and,

**TABLE I DISTRIBUTION OF RURAL CREDIT BY SOURCES, SRI LANKA: 1957 AND 1969**

Source	Percent of Total Borrowing			
	1957		1969	
<b>I. Institutional Sources :</b>	7.8		25.0	
of which: government .. .. .	2.6	2.7	4.1	9.7
cooperatives .. .. .	4.1	9.7	1.1	6.7
commercial banks .. .. .	1.1	6.7	—	5.9
other financial institutions	—	5.9		
<b>II. Non-Institutional Sources</b>	92.2		75.0	
of which: professional money-lenders	15.5	11.0	—	17.8
semi-professional money-lenders	—	17.8	7.4	14.3
boutique keepers .. .. .	7.4	14.3	4.1	1.5
merchants and commission agents	4.1	1.5	8.0	0.7
landlords .. .. .	8.0	0.7	44.2	25.8
relatives and friends .. .. .	44.2	25.8	13.0	3.9
others .. .. .	13.0	3.9		
<b>Total .. .. .</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Sources : Department of Census and Statistics, *Survey of Rural Indebtedness 1957*  
Central Bank of Ceylon, *Survey of Rural Credit and Indebtedness 1969*.

significantly, the repayments were satisfactory; a contrast to later periods.

In 1957 the credit scheme was handed over to the Department of Agrarian Services. By 1962/1963 the

total credit disbursed stood at Rs. 193 million whilst the amount in default was 9.4 percent of this amount. During this time a survey by the Department of Census and Statistics indicated that roughly 30 percent of the co-operatives were defaulters and hence not eligible for further loans and this gave rise to a decline in the volume of credit.

A Committee appointed in 1968 tied the Guaranteed Price Scheme for paddy purchasing to co-operative societies and thereby indirectly to the credit disbursement system. It was felt that by this process the peasant farmers who were members of co-operatives could obtain adequate credit. Other aspects of the recommendations of the Committee were compulsory recovery of share capital instalments from payments owed to members

**RURAL INDEBTEDNESS IN 1957**

The survey of Rural Indebtedness undertaken by the Department of Census and Statistics in 1957 was the first systematic collection of data on credit conditions in the rural sector. This survey disclosed that 54 percent of all rural families and 60 percent of agricultural families were in debt. The average debt per indebted family amounted to Rs. 790 for all families and Rs. 753 for agricultural families.

For the first time information was obtained on the sources of credit. Less than 8 percent of credit was from institutional sources. Co-operatives were the most significant source of institutional credit and accounted for over half of institutional credit or 4.1 percent of total credit. The distribution of credit sources is given in Table I above.

Informal sources of credit were varied. Relations and friends were the sources for as much as 44 percent of total debts, while landlords, who became less important subsequently, contributed 8 percent of total debts. Boutique keepers, traders, and commission agents accounted for 11.5 percent of total credit. The bulk of informal credit is therefore from non-professional sources with professional money-lenders accounting for only 15.5 percent of total credit.

Credit regional differences in the sources of credit were also observed. Co-operatives were significant sources of credit in Kandy (24.4 percent), Batticaloa (19.2 percent) and Polonnaruwa (24.4 percent) districts while less than 3 percent of total credit was from them in Colombo, Kalutara, Matale, Matara, Hambantota, Chilaw, Ratnapura and Kegalle districts. The uneven development of co-operatives in the different districts at this time perhaps accounts for this.

Relations and friends were a conspicuously large source of credit nationwide. Over 50 percent, of credit in the districts of Jaffna (55 percent), Vavuniya (59 percent), Trincomalee (59 percent) and Kegalle (61 percent) was from them.

Landlords were an important source of credit in Matale (22 percent), Nuwara Eliya (26 percent) and Batticaloa (35 percent) districts. Boutique-keepers were significant credit sources in Puttalam (41 percent), Anuradhapura (45 percent) and Ratnapura (31 percent) districts. Professional money-lenders were important credit sources in the Colombo (28 percent), Hambantota (32 percent), Chilaw (23 percent), Anuradhapura (27 percent) and Badulla (24 percent) districts. Itinerant traders were particularly significant lenders in the Chilaw district (29 percent).

The purpose of loans was classified into two broad categories of productive use and non-productive use. Productive loans accounted for 56 percent and unproductive loans for 44 percent of total debts. The productive use category included loans for cultivation, livestock trade, construction and purchase of vehicles, while the non-productive category included expenditures on food, medicine, ceremonial functions and the repayment of debts.

A significant feature of the purpose-wise distribution is that trade and construction were the main items for productive borrowing and accounted for about 30 percent of loans. Only 10 percent of loans were for cultivation and 12 percent for other agricultural loans. Commenting on the small proportion of agricultural loans the report said "these figures would indicate the inadequacy and

unsuitability of the present credit system to meet the basic needs of the peasant sector of the economy, particularly because of the present heavy emphasis on ownership rather than on productive capacity".

Interest-free loans are an interesting and unique feature of informal lenders. They are mainly the smaller loans, average size of which have been about Rs. 223. The 1957 data disclosed that while 13 percent of the number of loans was interest-free only 6 percent of the borrowed amounts were in this category. Over half the borrowed funds were in the interest group of 6-18 percent. About 22 percent of loans or 15 percent of the amount borrowed were at over 18 percent (See Table 2 below),

**TABLE 2 RATE OF INTEREST IN RURAL CREDIT MARKET 1957 and 1969**

Rate of Interest per Annum	Percentage of Total Borrowings	
	1957	1969
No interest .. .. .	6.2	34.4
Less than 6 percent	7.7	2.2
6 to less than 12 percent	24.4	32.5
12 and above*	42.0	30.9
Unspecified .. .. .	16.8	—
Other arrangements ..	2.9	—
<b>Total .. .. .</b>	<b>100.0</b>	<b>100.0</b>

\*In 1957, 21.8 percent of loans was above 18 percent while in 1969, 19.5 percent of loans were 21 percent and above.  
Source: Department of Census and Statistics, *Survey of Rural Indebtedness, 1957*; Central Bank of Ceylon, *Report of the Survey of Rural Credit and Indebtedness, 1969*.

from the Guaranteed Price Scheme; granting of further loans to defaulting co-operative societies for disbursement to non-defaulting members and an undertaking to be given by the borrowing members that they would sell an adequate part of their produce to the society to cover the loans taken by them.

Although these recommendations were implemented and credit was thereby liberalised the implementation aspects as regards to recovery were not followed through. As a consequence loans outstanding continued to rise.

#### Conditions in Rural Sector in 1961-62

The Department of Agrarian Services conducted a more restricted sample survey on rural credit in 1961-62. Cultivators in debt appeared to have decreased from 50 percent in 1957 to about 41 percent in 1961-62. The share of co-operative credit in total credit had risen from 4.1 percent in 1957 to 33 percent in 1961-62. But significantly non-institutional sources still provided about two-thirds of total credit. There was a conspicuous absence of landlords as a category of lenders due to the Paddy Lands Act of 1958 which prescribed maximum rates of interest on loans in cash and kind.

#### Rural Credit in 1969

The Central Bank conducted its Survey of Rural Credit and Indebtedness in 1969 under changed circumstances. The People's Bank had been established in 1961 with the specific objective of serving the credit needs of the rural sector and a scheme of rural banks under which selected co-operatives performed limited banking functions was inaugurated in 1967. The quantum of credit to the rural sector had increased substantially under the Government's Extended Credit Scheme of 1963 and the New Agricultural Credit Scheme introduced in September 1967. These significant incursions of financial institutions into the rural sector reflected in the share of credit from the institutional sector increasing from less than 8 percent in 1957 to about 25 percent by 1969. Credit from co-operatives and commercial banks showed a significant increase and the new category of other financial institutions accounted for nearly 6 percent of credit. The detailed breakdown of the sources of credit is given in Table 1.

Despite these developments in institutional credit these sources still accounted for only 25 percent of total indebtedness. Money lenders had increased their share of lending from about 16 percent (in 1957 and 1961-62) to nearly 29 percent. Boutique keepers accounted for 14 percent of total debts. Relatives and friends were once again an important source of credit and accounted for a quarter of total debts but their share of lending had declined significantly from the 1957 level. Although landlords had reappeared as a category of lenders they contributed less than one percent of total credit.

The purpose-wise classification of borrowing disclosed that 32 percent was for consumption of which a little over half was for food. About a third of borrowings was for capital expenditure of which nearly half was for housing. Of the thirty percent of borrowings for current expenditure, about two-thirds were for Agriculture and Trade.

Several other interesting features of rural credit emerged from the data of this survey. Most of the credit for housing, agriculture and trade was provided by institutional sources. The rural sector depended almost entirely on the non-institutional sector for consumption and current expenditure. Boutiques, landlords and commission agents gave credit almost entirely for food and household expenditure. Commenting on this the Report said:

*"This pattern of indebtedness has revealed that the emphasis placed by institutional credit agencies on credit for purposes of production has compelled the rural borrower to turn to the non-institutional lender to meet his credit needs for consumption purposes"*.

In 1967 a new credit scheme termed the New Agricultural Credit Scheme (see box on page 8) came into being recognising three factors:

1. Rising defaults.
2. Misuse of loans by borrowers.
3. Misuse of loan repayments by the societies.

The result of these changes was that future credit was to be channelled through the People's Bank which would have a supervisory function over the co-operatives. This new scheme was operated with a Central Bank guarantee of upto 75

percent of loans in default. The rate of interest paid to cultivators under this scheme was 9 percent and credit was to be supervised by the extension workers, the Cultivation Committee and the Committee of the Co-operative Society. A part of the loan was paid in kind, namely seed paddy, fertilizer, agro-chemicals and barbed wire. Even under this system both utilization and repayment continued to decline.

The Comprehensive Credit Scheme of 1973 envisaged that the total credit requirements of the peasants would be given through the Co-operative Rural Banks and branches of the Bank of Ceylon located in Agricultural Productivity Centres.

A problem that has always faced the institutional credit programmes is the high rate of default. The overall trend of both the New Agricultural Credit Scheme and the Comprehensive Rural Credit Scheme appears to have been the low rate of recovery. The reasons for default, as seen in Table 3, are also very revealing.

The credit granted to the peasant sector has increased steadily since the start of the various schemes. Thus the percentage increase by 1975/76 from a base year of 1947/48 was 2,310 percent which works out to an annual rate of 81 percent.

TABLE 3 REASONS FOR DEFAULT

Case of Default	% of Defaulters	% of Loans Overdue
1. Crop failure .. .. .	26.4	32.8
2. Low income .. .. .	17.2	16.2
3. No intention to repay .. .. .	12.0	14.6
4. Illness/death .. .. .	8.9	8.8
5. Indifference of Co-op. Officials .. .. .	8.8	6.3
6. Malpractices of Co-ops. .. .. .	7.8	5.0
7. Heavy expenditure (legal, ceremonial etc.) .. .. .	2.3	2.1
8. Considered loans may be written off .. .. .	2.0	1.6
9. Misuse of loans .. .. .	1.9	1.7
10. Considers loans to be outright grants .. .. .	1.7	1.7
11. Lack of irrigation facilities .. .. .	1.5	1.2
12. Heavy capital expenditure .. .. .	1.5	0.7
13. Malpractices of government officials .. .. .	1.6	0.8
14. Heavy indebtedness .. .. .	1.2	1.3
15. Unemployment .. .. .	0.4	0.2
16. Political interference .. .. .	0.4	0.3
17. Withdrawal of facilities to surrender rice ration books .. .. .	0.2	—
18. Others .. .. .	6.2	4.7
	100.0	100.0

Source: Central Bank of Ceylon.

## NEW AGRICULTURAL CREDIT SCHEME SINCE 1967

An important stage in the development of rural credit was reached in September 1967, when the new Agricultural Credit Scheme was introduced. For the first time the commercial banking network was entering such a scheme of lending to the rural sector or more specifically to the small farm sector. The People's Bank initiated the scheme and after operating it for nearly seven years, from 1974, the Bank of Ceylon has also participated in it. The Hatton National Bank too grants loans under this scheme but confines itself to lending for paddy cultivation in the Debara Ara Wewa Scheme.

This scheme was operated on re-finance from the Central Bank which lent funds at 1½ percent per annum to the commercial banks. The People's Bank which is the main lending bank in this scheme lends to co-operative societies at 5 percent per annum, and co-operative societies in turn lend to their members at a maximum rate of 9% per annum. The Bank of Ceylon lends directly at this rate of interest through its Agrarian Services Centres. When a loan is not repaid during the stipulated period a penal additional interest of 3 percent is added. Until 1970 the rice ration books of the farmer's household was hypothecated to the co-operative society and when a farmer defaulted in his repayment of loans each ration coupon was credited to the loan account at the rate of one rupee. Until 1978 the Central Bank guaranteed loans to the extent of meeting 75 percent of the amount in default and charged a fee of one half of one percent for this guarantee. This guarantee has been discontinued from October 1978 in the hope that its withdrawal would result in commercial banks developing a capacity to supervise and recover loans. The sudden liberalisation of agricultural credit in 1977 resulted in total loan disbursements reaching the unprecedented level of Rs. 534.1 million in the 1977/78 season. A significant contraction in Bank loans for cultivation could now be expected with the withdrawal of the Central Bank's guarantee.

Credit is extended for paddy and other crops including chillies, red onions, potatoes, vegetables, bombay onions, groundnuts, sugarcane, cotton and maize. The credit limit for paddy was initially fixed in 1967 at Rs. 220 per acre up to a maximum of 10 acres. Credit limits have been progressively increased to meet increasing costs of production. The loan limits are related to the variety of seed, cultivation practices and regions. Credit is given in both cash and kind by purpose and stages of production. Credit limits for paddy range from Rs. 380 to Rs. 810 per acre.

The volume of credit given for cultivation purposes has increased significantly. The increase in the volume of credit given for paddy cultivation can be gauged from Table 4 which gives the amount of credit given for paddy cultivation from 1947/48 to 1976/77 in three ten-year periods, as well as the amounts of credit given in the last two seasons. As can be seen from these figures there was a near doubling of credit in the second decade and more than a trebling of credit from the second

when as much as Rs. 420 million was disbursed. Credit given for paddy cultivation since 1967 and the repayment position is given in Table 5.

Until 1967 cultivation credit was given for only paddy. The volume of credit given for other food crops by the People's Bank increased progressively from Rs. 5.4 million in 1967/68 to Rs. 42.8 million in 1977/78. The Bank of Ceylon which lent out Rs. 36,000 for subsidiary crops in 1973, lent as much as Rs. 63.9 million in 1977. The volume of credit given by the two banks for cultivation of these food crops other than paddy, between 1967 and 1978, has amounted to Rs. 294.4 million.

A new scheme of credit called the Comprehensive Credit Scheme was envisaged in 1973. This scheme was to provide both production and consumption credit on a year-round basis through rural banks attached to multi-purpose co-operative societies. There was to be a greater flexibility in the granting of loans, and decisions with respect to requirements in different regions were to be decentralised. The scheme was expected to mature into a self-financing one by increasing the mobilisation of savings.

Although only some provisions of the original scheme have been applied the new agricultural credit scheme was renamed the Comprehensive Rural Credit Scheme.

TABLE 4  
LOANS FOR PADDY CULTIVATION

Period	Total Loans Granted Rs. Million
1947/48 — 56/57 ..	112.24
1957/58 — 66/67 ..	203.44
1967/68 — 76/77 ..	62.107
Total 47/48 to 1976/77	935.85
Maha 77/78 ..	420.27
Yala ..	32.44
Total 47/48 to 77/78	1,388.56

Sources: People's Bank; Bank of Ceylon.

to the third decade. There was an unprecedented increase in the amount of credit given for paddy in Maha 1977/78

TABLE 5  
CREDIT GIVEN FOR PADDY CULTIVATION SINCE 1967

Cultivation Season	Loans Granted	Rs. Million	
		Amount Recovered	Percent Recovered
Maha 1967/68 ..	61.42	52.86	86.0
Yala 1968 ..	11.29	9.80	86.8/
Maha 1968/69 ..	45.80	28.49	62.2
Yala 1969 ..	9.87	8.10	82.1
Maha 1969/70 ..	39.35	20.62	52.4
Yala 1970 ..	12.36	8.77	71.0
Maha 1970/71 ..	23.46	12.88	54.9
Yala 1971 ..	5.82	5.07	87.1
Maha 1971/72 ..	23.96	15.25	63.6
Yala 1972 ..	6.67	5.39	80.8
Maha 1972/73 ..	20.24	13.48	66.6
Yala 1973 ..	8.03	5.09	63.4
Maha 1973/74 ..	85.82	43.31	50.5
Yala 1974 ..	25.24	15.38	60.9
Maha 1974/75 ..	74.75	35.27	47.2
Yala 1975 ..	10.83	8.32	76.8
Maha 1975/76 ..	55.29	29.84	54.0
Yala 1976 ..	16.91	12.58	74.4
Maha 1976/77 ..	83.07	34.10	41.0
Yala 1977 ..	15.75	9.48	60.1
Maha 1977/78 ..	420.27	83.55	19.9
Yala 1978 ..	32.44	13.81	42.6
Total ..	1,088.64	471.46	43.3

Source: People's Bank; Bank of Ceylon; Hatton National Bank.

Although this increase has been subject to fluctuation the increase has been consistent. In spite of this increase, no direct causal relationship can be seen between the yearly provision of credit and output.

There has been no increasing level of output corresponding directly to the increase in the quantum of credit in different years. During the period 1947/48 to 1975/76 there were five peaks and 11 troughs with respect to the amounts of credit disbursed. However, one cannot observe a close relation in the output figures corresponding to these changes. For example, in 1960 to 1964 the paddy output increase was 5 percent compared to a 22.4 percent rise in amount of credit granted. Similarly in 1972, 1973 and 1974 credit rose by 376 percent whilst output increased by 26 percent. In contrast in 1959/60 paddy output increased by 18 percent at a time when the amount of credit declined by 24 percent. A similar phenomenon was observed in 1969/70 when output rose to 17.8 percent whilst credit declined by 7 percent. These figures indicate that although the increase in paddy production over a period of three decades is roughly parallel to the increase in credit it is difficult to relate the macro credit disbursement without observing the micro phenomenon at the village level.

Credit disbursements also seem to filter through a status/class hierarchy. A People's Bank survey of Rural Credit in the Central Region of Sri Lanka seemed to indicate this clearly. The selected sample questioned on whether the Rural Banks provided a useful service varied strongly in their views, according to income groups.

The majority of the upper income group found the services useful, whilst those in the case of the

lower income group who responded to the question, roughly an equal proportion found it useful as well as not useful. It is significant also that a large proportion of the lower income groups did not respond. The same pattern is seen in the evaluation of the services of Rural Bank employees by the same income groups:

at over Rs. 400 million of which the People's Bank's figure alone stood at Rs. 318 million. This season gave a record output, a fact also connected with good weather, but also resulted in a very poor recovery rate as seen in Table 5 on page 8. Credit criteria has been now tightened up again for Maha 1978/79

TABLE 7  
EVALUATION OF THE SERVICE OF THE RURAL BANK  
EMPLOYEES BY DIFFERENT INCOME GROUPS

Opinion	Lower 40%	Middle 40%	Upper 20%	All
Satisfactory .. ..	4	8	9	21
Unsatisfactory .. ..	6	4	—	10
No reply .. ..	14	12	3	29

Source: "Rural Banks in the Kandy District: A Case Study",  
People's Bank Research Department.

The upper income group finding the services satisfactory whilst a major portion of the lower income group found them unsatisfactory. (Table 7). Once again it is significant that a large percentage of the lower income group did not respond to this question.

Government sponsored credit schemes have tended to follow a cycle where an initial liberalization and expansion of credit distribution is followed by a high rate of defaults and a consequent clamping down on the volume of credit giving rise to a fall in the number of eligible borrowers. The twin objectives of disbursement as well as credit discipline are also governed by political factors whereby the credit tap is opened under non-banking political criteria.

By Yala 1977 total outstanding credit stood at Rs. 340 million. For Maha 1977/78 there was an official decision to relax conditions of credit disbursement and for banks to give credit even to defaulters. Credit disbursed for Maha 1977/78 stood

and credit is now given stringently and only for non-defaulters. Further the Central Bank has withdrawn its 75 percent guarantee for loans given to farmers by commercial banks.

The reasons for the high rate of default are many. The Central Bank of Ceylon which conducted a survey of reasons for failure to repay Agricultural loans adduced 17 reasons for default (see Table 3) which included low yields, crop failure, lack of interest of co-operative officials, use of funds for other purposes, malpractices of government officials, political interference and no intention of the farmer to repay loans. In other words some farmers do not repay because they are unable to, while others do not repay because they are unwilling to or think they need not repay. It is significant that 14.6 percent of loans were not repaid because the farmers did not have the intention to repay.

A survey carried out by the People's Bank in 1977 on an islandwide sample of members of Co-operatives gave the following reasons for default in cultivating loans (see Table 10 on page 12).

These broad reasons for default given by borrowers have been confirmed by other surveys conducted by the People's Bank.

Whatever the reason for non-repayment of loans it is clear that the large figure of non-repayment

TABLE 6  
OPINION EXPRESSED REGARDING THE SERVICE OF THE RURAL BANKS

Opinion	Lower 40%	Middle 40%	Upper 20%	All
Useful .. ..	3	11	17	31
Not useful .. ..	4	1	3	8
No reply .. ..	17	12	2	31

Source: "Rural Banks in the Kandy District: A Case Study",  
People's Bank Research Department.

## Rural Banks

An important innovation in banking to serve rural areas has been the scheme of Rural Banks inaugurated in 1964. The idea of formalised Rural Banking in Sri Lanka has to be traced to the establishment of the People's Bank in 1961. As stated by the Commissioner of Co-operative Development, Mr. W. Pathirana, in March 1969, on the occasion of the opening of the fiftieth Rural Bank, "the avowed purposes for which the People's Bank has been established are, (to quote from the People's Bank Act No. 29 of 1961) :— to develop the Co-operative Movement of Ceylon, Rural Banking and Agricultural credit, by furnishing financial and other assistance to co-operative societies, approved societies, cultivation committees and other persons". It is entirely due to the People's Bank, its appreciation of the realities of the village economy, of the dependence of the villagers, mostly farmers, on non-institutionalized credit at usurious rates of interest, its sympathy with the aspirations of the Co-operative Movement, its awareness of the role rural co-operatives could play in the alleviation, and eventual eradication, of the misery caused by the dependence of the villager on credit at exorbitant rates of interest, its foresight in evolving a scheme to help co-operatives realise their aspirations, and finally to the courage shown by initiating this experimental scheme, that "Rural Banks" have been established".

The first rural bank was started as a pilot project in March 1964, in a village co-operative society at Minikhinne in the Kandy District. The scheme was expanded to two other societies in April and May of the same year. Thereafter, as it became evident that the programme, in actual operation was working satisfactorily, the bank gradually stepped up its extension to other societies, and by March 1969, the number of societies brought within the scheme had reached the 50 mark. At the end of 1978, 183 rural banks

were in existence and there were a further 275 special branches affiliated to them.

When the evolutionary process of the rural banks since 1964 is examined, two phases are noticeable.

- i. An experimental phase from 1964 to 1972.
- ii. A phase of rapid expansion after 1972.

During the experimental phase the rural banks were set up only in selected co-operative societies. Therefore, their expansion was rather slow as may be seen from the following statistics.

TABLE 8

Year	Number of Rural Banks
1964 .. ..	3
1965 .. ..	8
1966 .. ..	13
1967 .. ..	27
1968 .. ..	44
1969 .. ..	68
1970 .. ..	70
1971 .. ..	111

A noteworthy characteristic of lending by the rural banks during this period is that the loans granted were restricted only to purposes other than paddy production, with loans for agricultural production, mainly paddy, being given by the co-op. societies.

After 1972 the number of rural banks set up increased rapidly. This increase may be partly due to the reorganisation of the Multi-purpose Co-operative Societies in 1972. With the reorganisation a large number of small and uneconomic Multi-purpose Co-operative Societies were amalgamated to form larger economic units (although the reorganisation did not meet all its ends, as we have discussed in our special issue on Co-operatives.) The societies then became fewer and it was possible to improve the level of management too. With these changes, setting up a rural bank for every reorganised society was followed as a matter of policy. As a result, by the end of 1973, the number of rural banks

rose to 341 i.e. there was a rural bank for each of the 341 Multi-purpose Co-operative Societies. Later when special branches of the rural banks were opened in the 'pradeshikas' of the Multi-purpose Co-operative there was further expansion of the rural banking network. The pace of expansion during the period may be assessed from Table 9.

After 1972, the rural banks came to be named "Co-operative Rural Banks." The nature and magnitude of business transactions of these rural banks from 1965 upto 1978 may be observed in the Table showing deposits and advances of the rural banks.

These rural banks and special branches provide limited banking facilities. They are departments of co-operatives and perform such functions as accepting Savings and Fixed Deposits and lending for specified purposes such as debt redemption, housing and consumption needs. Pawnbroking — lending on the pledge of gold and jewellery — is another important credit operation of these banks.

The advantages expected of Rural Banks are as follows: Rural Banks operate in a small area, their clientele is expected to be personally known, the operational costs are low and their less imposing structure makes it easier for people in villages to transact business. They also provide an economically viable means of enabling certain banking operations to be available to areas where the establishment of a fully-fledged branch bank is not economically feasible. After a few years of operation the issue was raised as to why these same facilities could not be granted by the People's Bank directly through an expanded branch network to individual farmers. It was found that the Bank in fact did lend to farmers direct as far as possible but it was not feasible doing this on a comprehensive scale, because of the peculiar characteristics of the rural economy and the position of the small farmers who comprise the majority of the rural population. Several thousands of these small-scale peasant farmers cultivated little plots of land, each averaging less than one acre, which many of them did not even own. Their incomes were low and securities they could offer were virtually nil. In such a situation it was necessary that credit decisions be based entirely on a close personal knowledge of each prospective borrower. The cost of a bank branch network necessary to acquire the basic "credit intelligence" and to issue and supervise the multiplicity of small loans during particular seasons and also the mechanics of recovering such loans would have been prohibitive.

This is where the village level co-operative assumed significance. Although the co-operative did not rate high

TABLE 9  
EXPANSION OF RURAL BANKS (1972-1977)

Year	No. of Rural Banks	No. of Special Branches	Total
1972 .. ..	242	—	242
1973 .. ..	341	—	341
1974 .. ..	332	71	403
1975 .. ..	338	109	447
1976 .. ..	345	158	508
1977 .. ..	285*	259	544

\* The decrease in the number of Rural Banks in due to the amalgamation of some multi-purpose co-operative societies. As a result of the amalgamation, a number of rural banks have been converted into special branches (Central Bank - Review of the Economy 1977, p. 33)

beside the conventional financial institutions, in a farming community where individual resources are so meagre the group strength inherent in co-operatives makes it an indispensable institution for promoting the economic well-being of individuals. It was accepted that the co-operative had many weaknesses in the existing set-up and this was to be expected, for it was a natural corollary of the paucity of resources of the small farmers themselves. Yet its potential to administer rural credit in agriculture was well known, for more than any other institution the co-operative had that close personal knowledge of farmer's capacities; a knowledge so essential in making credit decisions. The co-operatives themselves had several exist-

lending, this programme also carried with it a package of technical and financial aid designed to strengthen them.

The People's Bank came into assist the co-operatives by training personnel to carry on these credit functions, introducing procedures and providing credit facilities. Rural Banks deposit their funds with the nearest People's Bank branch.

The development of rural banks was an important institutional innovation. It marked a significant development for both savings mobilization and rural lending. The rural banks have incorporated a blend of the advantages of unit banking and branch banking and

tional methods to serve the rural sector. It has also been an experiment in transforming sophisticated devices into simple and functional means in the rural sector. Further innovative devices to meet the needs of the rural sector will be an important strategy in the development of financial institutions in this sector.

The experience has also underscored the importance of institutions in the mobilization of savings and their capacity to transcend the disadvantage of economic disincentives to saving, such as high rates of inflation and low rates of interest.

If the rural sector is to be serviced by institutional financial devices there is

TABLE 5. DEPOSITS AND ADVANCES OF RURAL BANKS, 1965-1978

In Rupees

End Year	No. of Banks	Deposits			Advances			Difference between Total Deposits and Total Advances
		Savings Deposits	Fixed Deposits	Total Savings and Fixed	Short-term	Pawning	Total	
1965	8	491,626	4,734	496,360	914,699	252,596	1,167,295	- 670,935
1966	13	703,011	22,737	725,748	1,326,457	427,129	1,753,586	- 1,027,838
1967	27	1,305,846	65,381	1,371,227	2,029,476	633,213	2,662,689	- 1,291,462
1968	44	3,110,576	222,614	3,333,190	3,630,731	1,085,613	4,716,344	- 1,383,154
1969	68	5,712,893	460,168	6,173,061	5,572,281	1,523,646	7,095,927	- 922,866
1970	90	16,109,287	799,117	16,908,404	7,122,213	1,980,066	9,102,279	+ 7,806,125
1971	111	17,188,297	676,106	17,864,403	7,144,913	2,171,734	9,136,647	+ 8,547,756
1972	242	22,703,136	617,150	23,320,286	8,226,663	6,958,250	15,184,913	+ 8,135,373
1973	341	44,281,601	872,935	45,154,536	16,177,708	22,734,438	38,912,146	+ 6,242,390
1974	RB 332 } SB 71 }	61,549,118	1,186,243	62,735,361	29,008,262	38,398,508	67,406,770	- 4,671,409
1975	RB 338 } SB 109 }	72,833,867	1,380,104	74,213,971	37,387,369	49,898,203	87,285,572	-13,071,601
1976	RB 345 } SB 158 }	114,495,097	1,793,923	116,289,020	47,624,595	54,167,951	101,792,546	+14,496,474
1977	RB 285 } SB 259 }	170,514,871	4,947,329	175,462,200	55,034,180	55,849,120	110,883,300	+64,578,900
1978	RB 283 } SB 275 }	209,607,670	12,537,698	222,145,368	63,763,200	61,315,568	125,078,769	+97,066,599

RB--Rural Banks. SB--Special Banks

Source: Central Bank of Ceylon

ing weaknesses but yet it was deemed necessary to exploit their potential for this purpose. They were found to suffer from serious managerial and operational shortcomings while their initial resources were woefully limited. Together with this new credit programme therefore it was decided to operate parallel programmes to reorganise and strengthen these societies. The Rural Bank scheme was thus an exercise in rural credit incorporating such a dual programme. While providing co-operative societies with funds for re-

operated through a known and existing institution the co-operative. It has used methods of lending well-known to the rural community, like pawnbroking, and some rural banks are known to have devised innovative means of mobilizing savings.

A study assessing the role and performance of co-operative rural banks, carried out by Nimal Sanderatne and S. Kahagalle, concluded that "the rural banks scheme has demonstrated both the need for, and the capacity of, insti-

a crying need for a proper understanding of the nature and operations of the unorganized, informal money markets which still operate to a very significant extent in the rural sector. The study and understanding of these markets would provide a useful basis for devising policies, methods and techniques of providing finance for this sector and for devising innovative means of mobilizing savings as well. The existing network of rural banks and co-operatives could itself be used for this purpose".

**TABLE 10 REASONS FOR DEFAULT IN THE REPAYMENT OF CULTIVATION LOANS**

<i>Reason</i>	<i>Number that gave reason</i>	<i>Percentage</i>
1. Crop failure .. .. .	148	65.78
2. Lack of extension work .. .. .	16	7.11
3. Investing in other activities .. .. .	18	8.0
4. Considering loans as Government aid .. .. .	13	5.77
5. Settling other debts first .. .. .	15	6.67
6. Other reasons .. .. .	15	6.67
<b>Total .. .. .</b>	<b>225</b>	<b>100.0</b>

Source : *People's Bank Research Department*

implies that credit has become in effect an indirect subsidy for the farmer and in the case of non-repayment due to crop failure a substitute for insurance.

### Commercial Bank Branch Expansion

The expansion in rural credit has not been confined to the increases in credit for cultivation purposes. The extension of the institutional network to rural areas has been rapid in recent years. The People's Bank had 216 branches at the end of 1978, many of these being in rural areas, and was also servicing the 283 rural banks and their 275 additional special branches. (See box on Rural Banks). The Bank of Ceylon, which till recently concentrated on urban areas, has also ventured into remoter areas. At the end of 1978, it had 480 branches of which 390 were sub-offices at Agrarian Services Centres.

### Total Bank Credit to Rural Sector

A complete picture of institutional credit for the rural sector is not available due to the lack of data on credit for all purposes given by all institutional sources.

Some estimates place total credit to the rural sector in 1978 at about Rs. 400 million. Of this nearly 75 percent had been given out as cultivation loans, while nearly 10 percent was for purchase of machinery, 5 percent for housing and electrification, and the balance 10 per cent for animal husbandry, crop diversification, small industry,

debt redemption, consumption, trade and other miscellaneous purposes.

Credit given under the Comprehensive Credit Scheme for cultivation was the single largest item of credit in 1978.

### Credit for Tree Crops

While there has been an appreciable expansion of credit for paddy and food crops, credit programmes for tree crops grown by small-farmers are very limited. Small farmers growing such crops as coconut, tea and rubber have generally had little access to institutional credit. They have benefitted mainly by subsidies for replanting and fertilizer. The provision of credit for these crops is particularly important as small-holdings have increased since the Land Reforms of 1972 and 1975. A certain amount of land held by estates has been re-distributed as small-holdings and these small-holdings cannot be expected to maintain or improve their productivity without adequate credit.

Tree crops are characterised by a long period of gestation. Therefore credit for these crops should allow for repayment after several years when the crops yield a return. Credit is required for new planting, replanting and for fertilization and upkeep of the crops till they begin to bear. Besides, intensive land utilization requires inter-cropping and underplanting all, of which require augmented fertilization.

Recently a new credit programme for coconut small-holders has been

worked out. All growers of coconut of less than 25 acres but excluding home gardens of less than 1/2 an acre are eligible. Repayments begin after 2 years and are spread over 5 years. The People's Bank and Bank of Ceylon will operate this scheme on Central Bank refinancing which will initially amount to Rs. 15 million per year for 2 years. Credit limits are based on a maximum of 640 lbs. of fertilizer per acre.

### Tobacco Credit

One of the success stories of an integrated credit scheme is that operated for the cultivation of tobacco. In this scheme the assistance given by the People's Bank has been complementary to that extended by the Ceylon Tobacco Company and the results of this co-operation are evident in the comparative prosperity which it has brought to the peasant farmers in these tobacco areas. This scheme for granting of loans for growing tobacco was initiated in the late 1960's in conjunction with the Department of Agriculture and Ceylon Tobacco Company on lands which were not suitable for growing other crops. The basic features of this scheme were that facilities were given to barn owners who could not furnish security and who were not income tax payers up to Rs. 4,000/- per barn on the security of other barn owners. Those who owned two or more barns were able to obtain loans to Rs. 6,000. The loan and the interest are repaid out of the proceeds collected when the tobacco is sold to the Ceylon Tobacco Company. The Company provides the planting material, fertilizer and other agro-chemicals. Its extension personnel give advice on the growing of the tobacco and purchases the crop at a price fixed at the commencement of the season. The value of inputs provided is deducted from the gross sales income of each farmer. Farmers achieve a high level of productivity and are generally satisfied with the prices and marketing arrangements.

This is a model of lending that could be utilised for other crops which need to be processed and which are grown by small farmers in a fairly contiguous region. It could

also be used by agencies set up to develop land and settle for cultivation. The banks could lend the finances to the commodity processing agency which could establish the necessary infrastructure to serve the farmers. Sugarcane, coffee, tea and rubber are crops which could be served in this manner. Where the crop is directly consumed or there are competing purchasers of the produce, the credit/input giving agency runs a risk—the farmer could sell the crop to others and the hold of the lender is weakened.

### Dairy Development Credit

An important recent development in credit is the new loan scheme for dairy development initiated by the Ministry of Rural Industrial Development. Plantation workers on estates in the Nuwara Eliya District will be given a loan of Rs. 2,500/- per cow for two cows at an interest rate of 9½ percent. The Superintendents would have to certify that there are cattle sheds and facilities for the rearing of the cattle. They are to exercise supervision of the livestock and organize the marketing of the milk to the Milk Board. The Superintendents are responsible for the recovery of the loan from the wage payments and Milk Board payments.

This scheme is interesting as it has used an existing institutional framework of another agricultural sub-sector to provide the facilities and supervision of the enterprise as well as to recover the funds lent. The supervisory functions of the estate Superintendents can ensure the proper use of funds while the employment on the estates provides security for the loan. It would be useful to find other enterprises in which these principles can be used to grant credit to commence or expand them in the rural sector.

### Problems and Weaknesses of Institutional Credit

The most serious problem which institutional credit programmes have faced is the inability to recover a large proportion of the funds lent to farmers. This jeopardises the capacity of credit-giving agencies to continue their programmes, or

when the Government has used its funds it creates a financial burden to the Government. Besides, this there is evidence that funds meant for agricultural purposes have been used for other purposes. On the other hand, it is likely that deserving and eligible borrowers do not get credit.

The rates of recovery of paddy loans given in Table 5 indicate a recovery rate of only 43 percent for the entire period 1967/68 to 1977/78. A trend of declining recovery rate is also observable in this data. In Maha 1977/78 when a record sum of Rs. 420.3 million was lent only Rs. 83.5 million or 19.9 percent had been recovered by the end of 1978. About 7.5 percent of these loans though due are not in default. The rates of default for subsidiary crops which were low initially have also increased over time. While only about 17 percent of subsidiary crop loans given by the People's Bank was in default in the first two years 1967/68 and 1968/69, the rate of default has increased to nearly 45 percent in 1977/78. Loans given by the Bank of Ceylon have suffered a similar fate — only 43 percent of funds lent for paddy and 21 percent of funds lent for other crops have been recovered during the period 1973/74 - 1977/78.

The most serious weakness is that the village level organisations are unable to lend on the basis of farmers credit worthiness, supervise the use of funds for the intended purposes and ensure the recovery of funds. Although commercial banks entered the field of rural credit in the 1960s the credit agency finally giving credit to the farmer in most cases is the village level co-operative. These co-operatives are poorly staffed, accused of corruption and have not shown an ability to supervise the lent funds. Consequently credit intended for farmers has been used for other purposes and those borrowing funds do not feel an obligation to repay.

Commercial Banks despite their involvement in rural credit programmes have not developed a complete capability to supervise credit disbursements and improve their credit supervision. One reason for

this 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.

### Credit and Other Supports

Rural credit for today's paddy farmer is not to be seen in isolation but as part of a package of supports for the farmer, which after the introduction of the new technologies included extension work, fertilizer subsidies, guaranteed price schemes and more recently insurance. The selling price of paddy is at least partly dependent on the Guaranteed Price Scheme (GPS) price and the profit that the farmers can get varies with the guaranteed price as well as on other factors. The profit is largely related to the ability of the farmer to repay loans. The amount of surplus accruing to a farmer who sells at the Guaranteed Price Scheme level are indicated in the following figures taken from a study conducted by the Agrarian Research and Training Institute (see Tables 11 and 12).

The ARTI study carried out during the 1976/77 Maha season gave the following production costs per bushel and profit margin if the produce was sold under the GPS indicating that profit margins were still adequate. With a certain stabilization of prices the paddy purchases has improved in the subsequent years.

However, the operation of the Guaranteed Price Scheme depends on several factors. At the level of the Co-operatives, sometimes the farmers are unable to sell their produce to the Co-operatives partly due to the seeming remoteness of their purchasing apparatus compared to the private sector which tends to be more flexible. This means that at the village level, the problems of paddy purchase is governed by factors of micro-political economy as much as the national policy which fixes the Guaranteed Price Scheme.

Further, there is variation in the amount of paddy going to co-operatives (hence through the GPS) and the private trader in different parts of the country. The following

**TABLE 11 Profit Margins and Production Costs for Paddy Districts**

Item		Polon-naruwa	Hamban-tota	Kandy-Kegalle	Colombo
Production costs .. ..	(Rs.)	24.39	23.00	25.44	29.75
Profit margins in relation to the Guaranteed Price of Rs. 33.00 per bushel .. ..	(Rs.)	8.61	10.00	7.66	3.25
Profit margin as a percentage of production costs .. ..	(Rs.)	35	43	30	11

data from the ARTI study of modes of disposal of paddy output indicates this.

The ability of a farmer to repay his credit is directly related to his ability to sell his output at a reasonable price. Although the GPS potentially gives this fair price this is not always received; the difference between the GPS price and the price at which the farmer sells his produce varying from district to district.

**Credit and the High-Yielding varieties**

The use of high-yielding varieties has required a high credit input because the physical inputs now cost more. The varieties of paddy used in Sri Lanka can be arranged on four tiers depending on whether traditional varieties are used (poten-

tial yield 40 bushels per acre) the improved traditional varieties (potential yield 60 bushels), the old high-yielding varieties (80 to 100 bushels) or the newer high-yielding varieties (120 to 140 bushels yield potential).

By the early 60s the "H" early high-yielding varieties had begun to spread very widely so that by 1970 over 70 percent of the sown area was covered by these. The situation for 1973/1974 of the three broad seed categories of traditional new high-yielding and old high-yielding varieties are as below.

Seed Variety Adopted Maha 1973/74		% of farmers
New high-yielding varieties	..	42.0
Old high-yielding varieties	..	33.3
Traditional	..	24.7

Source : Crop Cutting Survey

**TABLE 12 Modes of Disposal of Paddy Output (Quantity Disposed as a Percentage of Total Output)**

Mode of Disposal	Polon-naruwa %	Hamban-tota %	Kegalle-Kandy %	Colombo %
(a) Sales				
To Co-operatives .. ..	67	23	10	—
To Private Traders .. ..	3	32	12	13
	70	55	22	13
(b) Payments in kind				
Landlords share .. ..	—	9	10	5
Others* .. ..	3	12	5	4
	3	21	15	9
(c) Home Retention				
For consumption .. ..	24	20	59	75
For seed .. ..	3	4	4	3
	27	24	63	78
Total output per form :				
(Percentage) .. ..	100	100	100	100
(In bushels) .. ..	273	197	36	23

\* Includes loan repayments, payments in kind to hired labour and draught power.

Despite this adoption of high-yielding varieties having a yield potential of between 100-140 bushels per acre, the national average remains around the low figure of 50 bushels.

**Fertilizer**

Fertilizer is another aspect of the total package surrounding credit use and fertilizer has been given under a subsidy scheme now amounting to 50 percent and fertilizer use has increased dramatically over the years, but has tended to be price responsive as was shown in the drop in its use in 1975 because of the cut in the fertilizer subsidy.

**TABLE 13 Fertilizer Issues for Paddy (Thousand Tons)**

1961	..	29.0
1962	..	38.1
1963	..	47.1
1964	..	60.1
1965	..	42.0
1966	..	44.1
1967	..	73.2
1968	..	85.2
1969	..	83.5
1970	..	87.1
1971	..	95.4
1972	..	88.4
1973	..	125.5
1974	..	96.4
1975	..	48.7
1976	..	72.4
1977	..	81.5
1978	..	113.3

Credit disbursement, its use and recovery therefore are not dependent purely on financial criteria. It depends on the size of the farms and their ability to get a surplus to pay back the loans. Further it also depends on the prevailing tenure systems and the proportion of paddy left for the farmer. It is dependent on the marketing system and the prices the farmer gets. It is also potentially dependent on the insurance supports for the farmer, use of fertilizer and new high-yielding varieties with the associated agrochemicals. Vagaries of climate also influence it strongly, (which the insurance scheme is expected to cushion the farmer from). However, the most important factor is the social matrix within which credit is perceived by the farmers. In a

highly politicised situation as in Sri Lanka, credit has often been a part of politics and one has seen the credit tap being opened and closed on criteria unconnected with paddy production. In such a psychological regime rewarding farmers for non-repayment by giving them further loans leads to cynicism and the good farmer who pays back his loan is looked at with subtle ridicule by other farmers whilst the non-paying farmer is often considered the folk hero. (In certain parts of the North Central Province because of the prevailing climate built up over the decades, days of loan repayment are referred to in lighter vein as "cultivation pay-days"). In such instances credit becomes in fact an indirect subsidy to the farmer and in the case of non-repayment due to crop failure the substitute for insurance. More damagingly it breeds cynicism.

### Insurance

The crop failure risk is a major factor in discouraging peasant initiatives and counteracts the benefits of other programmes such as credit, guaranteed price schemes and extension programmes. It has a direct bearing on credit and rural indebtedness. Natural disasters such as drought, floods, pests and diseases enlarge the uncertainties the farmer has to meet with and these act as disincentives for increased production and adoption of improved methods. Insurance in the agricultural sphere theoretically assures farmers financial protection that would allow them to continue cultivation even after a crop failure. Sri Lanka is one of the few countries where attempts at crop insurance have been made. (A strong case is made for such a scheme in India, see box on pages 16 and 17.)

The paddy crop insurance programmes have been in operation, although in a seminal form, since 1958. In the Maha season of the latter year approximately 26,000 acres in five of 22 revenue districts were selected for a pilot project. In 1962/1963 the area covered by insurance was enlarged to 65,000 acres in eleven districts. This was further extended to cover 200,000 acres in 16 revenue districts by Maha 1973/74.

By the early 1970s there was a realisation that there were inherent defects in the scheme as reflected in the very low premia collected as well as in the high rate of indemnity payments. Consequently a new Agricultural Insurance Law of 1973 was introduced which attempted to establish a system of compulsory insurance for paddy. This scheme was to be administered by the Agricultural Insurance Board and premium rates were to be fixed on a regional basis. The Agricultural Insurance Scheme under the new approach commenced operations in Yala 1975 and was expected to cover the entire area under paddy.

The scheme in 1975 had as the unit of insurance the Cultivation Committee area and not the household as earlier. Individual farmers were expected to register with the Cultivation Committee and enter their lands for insurance purposes. It was expected that the insurance agency would by this means deal with only 5600 'insureds' as against the over 900,000 household units. It was expected that the Agricultural Productivity Committee of the Cultivation Committee would be the primary link with the farmer. For purposes of determining premia and for purposes of assessment of loss each 'stretch' (Yala) in a Cultivation Committee was to be taken as a unit of assessment.

It was found that at the village level this arrangement also gave rise to several irregularities: "Farmers" who did not cultivate were able to get their names into the Insurance register through their informal contact with the Cultivation Committee, often on political patronage criteria. As a consequence the Agricultural Insurance Board at times refused to pay indemnities in such cases. With this refusal to pay, even though on correct grounds, the farmers have tended to take the scheme far less seriously than it should be.

After the introduction of the new scheme in 1975 insurance was made compulsory for the granting of cultivation loans by the lending authorities. When loans were approved to individual co-operative societies the latter were expected to recover premia and forward them to the Agri-

cultural Productivity Centre within the area of operation. The premia varied from Rs. 8 to Rs. 30 per acre for a cultivation season depending on the area, the figure being decided by the Insurance Board in consultation with the APC. However, the scheme was not strictly followed in the initial years and it actually commenced only from the 1975/76 Maha. In 1976 premia rates were revised again and new rates were effected from the 1976/77 Maha season. When the cultivation loans are granted to the co-operative societies the banks are expected to satisfy themselves that the whole crop was insured. The insurance premia varies with the area of cultivation and is fixed by the Insurance Board in consultation with the APCs. A higher premium, three times higher than the others, for those farmers who claim cultivation loans has been introduced as a compulsory measure for the current 1978/79 Maha season. This has been done largely at the insistence of the Banks which have had a very bad experience in regard to recovery of cultivation loans. It is too premature to assess this latter scheme.

The figures quoted in Table 14 of insurance premia collected and area insured in comparison with the total loans given indicate that the system has not been effective as yet.

It is seen that the area covered under insurance continues to be small. In Maha 1976/77 only 22 per cent of the total acreage cultivated was insured, compared to 17 per cent of the acreage for the previous year. Premia collected for 1976/77 Maha were only 20 per cent of the premia expected and represents a marginal decrease compared with the Maha season of the previous year.

For Yala 1977 the area insured was only 8 per cent of the total cultivated area and premia collected were also only 8 per cent of the premia due, which is less than the figure for previous Yala 1976. The last column in the table indicates that the difference between indemnities paid and premia collected was positive in Maha 1976/77, as well as in Yala 1977. This contrasts with the previous three seasons which had

## RURAL CREDIT AND BANKING—The Indian Situation

B. Natarajan

The situation of the rural peasant and the small farmer is much the same in most developing countries of Asia. Institutional credit has yet to make a major impact on his conditions of indebtedness and the hand-to-mouth existence he is often compelled to lead. In this paper, written in 1977 by Dr. B. Natarajan in the *Tamil Nadu Journal of Co-operation* (we publish only excerpts) he emphasises that credit is not all; and farming alone can hardly be expected to generate sufficient income surpluses to get these rural people out of the poverty trap. His paper shows many parallels to the Sri Lanka situation in the measures being adopted to tackle this problem.

Credit is a vital factor of the production function. More so in India's agriculture, where the prospects of 'plough back' are weak compared to trade and industry. For the farmer, credit therefore, is no less important than other inputs like seeds, fertilizer, water, etc. The persistent low production in agriculture in many parts of the country can be attributed to the inadequate and none-too-timely supply of agricultural credit.

To channelize agricultural credit both in terms of adequacy and timelines, the first step should be to institutionalize credit. The starting of the co-operative movement in the beginning of the century was therefore hailed with great hope and expectations. But it failed to show results commensurate with the country's requirements. As of today, after over seven decades of its existence, the co-operatives hardly account for about 30 percent of the total needs of the agriculturists; and that, by-passing, as it were, the small, marginal and low income brackets in the farming community.

The possibilities of commercial credit to agriculture became a reality only after the advent of social control and the subsequent nationalization of 14 major banks in 1969. In fact, one of the compelling reasons for nationalisation was the need to extend credit to the neglected sectors in the economy such as agriculture, small-scale industry, etc.

What made the commercial banks neglect agriculture prior to nationalization? Banking tradition in the country and elsewhere had much to do with it. The banking industry being highly competitive, risky advances had to be kept at a minimum. Loans to agriculture were considered highly risky. Also land, which was all that the farmers could offer as security, was not welcomed by the banks because of its illiquidity, and other problems involved.

Further, the country was held in the belief that in co-operation and co-operative credit alone lay the salvation of the farmers and the solution to their credit needs. Co-operators themselves were largely responsible for this belief and they sedulously fostered the credo. 'Find Raiffeisin' and you will have found everything else. They lived and hoped for the day when the co-operative commonwealth dawned as a solution to all their problems, farm credit taking the

place of priority. To few did it occur in that halcyon period that commercial banking credit could be a second string to the credit bow; a source that can fill in the gap in their credit supplies.

Above all, until the country was faced with recurrent food deficits in the face of a growing population pressure, the Agricultural sector itself had been relegated to a secondary place in our development thinking. The nation was concentrating on the building of an industrial infrastructure that will itself be an eventual support for rapid agricultural growth on modern lines. Looking at this with hindsight, few can question today the wisdom of this growth strategy. However, the wheel has turned the full circle and the time has come for priority attention to the development problems of the agricultural sector.

After 1969, the 14 nationalized banks became a potent weapon in the hands of the government which decided that the resources of the public sector banks should supplement those of the co-operative banks in the supply of farm credit.

An analysis of the credit development of public sector banks to the agricultural sector shows that an amount of Rs. 650 crores had been provided as direct finance and another 300 crores of rupees or so as indirect finance by the end of 1975.

Public sector banks have also been increasingly associating themselves with the financing of primary agricultural credit societies. The scheme is fast gaining currency among the states, and in more than half of the states this joint effort in meeting the farm credit requirements is in operation. Over two thousand primary societies have been taken over so far by the public sector commercial banks. Nearly two lakhs of new members have been admitted to these co-operatives and the advances to them stand well over Rs. 20 crores.

In addition to short-term loans for agricultural operations, the banks have also disbursed medium-term loans for investment purposes, besides extending credit for stocking and distribution of agricultural inputs.

However, in spite of the fact that nearly 40 percent of the commercial bank branches are located in the rural areas and that over 800 crores of rupees have been disbursed so far, and in spite of the claim made in commercial banking circles that

agricultural credit advanced by banks at present accounts for nearly half of the total credit requirements of the agricultural sector is met by them it is necessary to point out that the banking staff are still urban-based, and are ignorant of local conditions; that the loan procedures are not sufficiently flexible and that on the whole the banks have not come up to the expectations in assisting agriculturists, these should be taken up as a challenge by the commercial banking sector.

Our farmers are essentially of two groups; those who are rich and those who are poor. The former who have ample security to offer and enough own resources to deploy are least affected by the availability or non-availability of credit. In fact, they themselves engage in lending activities often. The poor who form the bulk of our peasantry are at the subsistence level with virtually no surplus left for future investment or production. After the harvest is sold, they are left with just enough for their consumption after paying the creditors back. If they are to raise the next crop—they have to obtain credit again all through their round of operations. Thus they need credit to buy seed, fertilizer and pesticide, to hire labourers or tractors, to instal pumpsets or dig a canal, etc. Here again the needs of different farmers will be different depending upon the mode of cultivation, selection of crops, nature of land, etc.

Desperate to start their next crop and having been shown the cold shoulder by the commercial and co-operative banks in the absence of the necessary security or surety, the farmers have no option but to go to the money lenders, however, harsh their terms and however high their interest rates may be. The money-lenders who may lend in trust may not hesitate to recover by threat. This was the position until recently and now with the disappearance of the private money lending agencies and pawnbrokers consequent on the promulgation of various ordinances by the then Government the plight of the villagers has become even more trying.

Thus it is that for the small and marginal farmers living at subsistence level, whose credit needs demand the highest priority, provision of short-term loans alone will not help tide over the problem. While the short-term advances to farmers owning less than 5 acres of land accounted for nearly 45 percent of the total agricultural advances and long-term advances were a mere 16 percent of the total advances. The final solution should be to make each farmer self-sustaining and self-reliant. This can be done only by providing the farmers with credit to instal permanent overheads like wells, tractors, motors, etc., which would render the holdings viable.

Considering the present rural set-up, it is evident that the commercial banks would have to restructure themselves to conform to the requirements of the rural sector, their traditions and practices. In some ways the new approach of the banking system functioning in the countryside

TABLE 14  
OPERATIONS OF THE AGRICULTURAL INSURANCE PROGRAMME  
(POSITION AS AT END OF 1977)

Season	Area Cultivated	Area Insured	Premia due	Premia Collected	Difference between Premia due and Premia Collected	Indemnities Paid	Difference between Indemnities Paid and Premia Collected
Yala 1975 ..	824	54	8,665	800	7,865	1,299	- 499
Maha 1975/76 ..	1,147	198	18,377	3,854	14,523	4,734	- 880
Yala 1976 ..	642	114	8,490	1,568	6,922	2,846	- 1,278
Maha 1976/77 ..	1,329	288	21,158	1,155	17,003	3,091	+ 1,064
Yala 1977 ..	718	58	9,523	801	8,722	452*	+ 349

\* Incomplete data

Source: Agricultural Insurance Board; and Department of Census & Statistics.

should be on the same lines as the private money lending agencies in that credit should be flexible and timely. But the interest rate charged should no doubt be appreciably lower than that charged by the money lenders and repayment instalments easier. Further, the banks acting as agents of development and social change should give their prospective borrowers positive guidance as to how they could make their borrowed funds productive, so that repayment is practicable.

But credit is not all. It is but one of the inputs, though a crucial input in farming. The end and aim of credit is to make farming a viable proposition. As it is, despite the vast investment made by the Government by way of augmenting the infrastructure facilities, like irrigation, power, etc. the numerous incentives given to the farming sectors and the far-reaching changes affected in agricultural practices through the "Green Revolution", it is disappointing to note that farming still remains a way of life, rather than an economic proposition.

The notion that prevails in some quarters that the agricultural terms of trade have been constantly rising, and that this upward trend has redistributed income in favour of the agricultural sector is largely based on the theoretical concepts little applicable to the vast diversities of the agricultural sector in the country. To generalize for the entire agricultural economy of the country from the experience of few prosperous pockets in Punjab and Haryana is an exercise in faulty methodology pregnant with wrong leads for the policymakers. It is one thing to say that the prices of farm products require to be maintained at reasonable levels as a measure of checking inflationary pressures, and that rich farmers should be made to pay unto Caesar what is Caesar's, but a far different thing to say that farming is an Eldorado, and farmers the plutocracy of the countryside.

A recent field study conducted by the Institute for Techno-Economic Studies, Madras, covering a sample of farmers

growing the four major crops, sugarcane, paddy, cotton and groundnut in Tamil Nadu has revealed that the net income from farming is still calculated to perpetuate farming as a way of living only. A net income of Rs. 500 for paddy, Rs. 300 for groundnut, Rs. 400 for irrigated cotton and Rs. 900 to Rs. 1,000 for sugarcane was all that a one-acre farmer got. This excludes capital expenditure on land and interest on working capital, land revenue and cesses which were not taken into consideration in computing the aggregate cost. On this level of income a whole family has to subsist for a period of several months in the year.

India being, what is termed a "geographical absurdity" and the conditions affecting agriculture widely diverse, to base the prices of farm produce on the findings of a monolithic Prices Commission at Delhi is as absurd as it is unfair.

However, neither supply of adequate and timely credit, nor fixing of remunerative prices for farm products will make farming a viable sector and a business proposition. Nor can farming wait till a vast infrastructure by way of more irrigations works, and power projects are taken up and completed. Science and technology too can help but little as long as the risks to which farming in this country is heir to from the vagaries of nature, droughts and floods, pests and tempests remain a serious menace to agricultural stability. Here it is a comprehensive and, if need be, a compulsory scheme of crop insurance has its relevance, significance and urgency.

Even as was done in nationalizing commercial banks, a bold stroke or act on the part of government is called for. The hesitancy on this score based on mistrust of farmers and exaggerated calculations of cost is ill-advised. A comprehensive scheme of crop insurance, debated for long and delayed in the process, will serve as a scheme of social security, specially relevant to an agricultural country like ours and as measure of agricultural stability and progress at once. Farming as an occupation has been condemned to a precarious existence for too long.

negative balances due to unprecedented droughts. The latter necessitated a high degree of subsidy by the Board.

It should also be noted that figures for premia collected, shown in the Insurance Board figures, is apparently undervalued. According to our investigations the individual co-operatives have not yet paid the premia to the Insurance Board. (For example, for the 1977/78 Maha season we came across several such instances, in the Dry Zone non-irrigated areas, amounting at times to about 0.7 million of unpaid premia).

It should be noted in summary that the first few years of the scheme were marred by several successive drought periods. The situation improved from 1976 onwards and preliminary indications, from the figures quoted above, therefore are that the new scheme is promising although it is still premature to make a more firm estimate. All agricultural credit is now theoretically tied to insurance which on paper should provide cast-iron guarantees for both lending bank as well as borrowing peasant. Yet this, like all centrally planned measures, will have to prove its worth in the real arena at the village level.

### Conclusion

An important implication that has emerged in this discussion is that credit policies alone cannot be expected to solve the problems of the rural sector. Many problems of the rural sector arise out of the fundamental structural deficiencies that have arisen and grown ever since the dualistic split began to appear in the country's economy from the early colonial days. When viewed in perspective it appears that these problems can be resolved mainly by devices such as agrarian reform encompassing tenure changes and development of firm village level institutions.

Credit to the rural sector must be viewed as a facet of agricultural development policy where the provision of infrastructural requirements and institutional structures are a prerequisite, credit for agriculture could be effective only if

integrated with other measures such as the availability of improved technologies and extension services, the provision of irrigation and transport facilities and adequate prices and marketing facilities.

Another aspect of the indebtedness problem is that credit for consumption remains largely outside the orbit of institutional credit. The observation of several decades ago that institutional credit is for specific production purposes and that this limitation implied that the most pressing needs of the rural sector, cannot be serviced by institutions remains largely valid today. Rural Banks have made only a limited impact on consumption credit but their success in mobilising savings should provide a sound basis for expanding their loan operations.

The distinction often made between production credit and consumption credit with the limitation of credit to the former is also counter productive. Consumption needs are often prior needs and if they are not met, production credit would either be used for consumption or where it is not possible to use credit for consumption owing to credit being given in kind, a farmer's commitment for consumption credit will reduce the effectiveness of production credit.

There is an implicit assumption in discussion of credit that institutional credit is "good" and that informal credit is "bad"; that institutions charge low rates of interest and informal lenders high rates of interest. These are not necessarily the perceptions of peasant farmers. To them the flexibility of the informal sector is sometimes more important.

As one of our economists stated recently "It may be heretical to suggest that the institutional sector itself lends to informal lenders. But increasing non-institutional liquidity could create a competitiveness in the informal credit market which would reduce interest charges". Given the advantage of the informal sector to operate in the rural sector such a policy may serve its needs well. Alternatively the secret to the success of the institutional sector lies in its ability to approximate the informal sector.