

Banking Services in Post-conflict Development of the North and East of Sri Lanka

Introduction

An effectively functioning banking sector is essential for a rapid economic growth of a country. Although in the past, banks have been shown on the supply side of economic models, today, they have changed their position from credit-creating institutions to multi-tasking institutions. Banks, not only grant long-term and medium-term loans and promote saving habits among their customers, but also serve in various dimensions, such as, finance service, insurance, housing subsidies, scholarships, foreign travel, etc. The banking and financial services sector is contributing 7.5% to the Gross Domestic Product of Sri Lanka in 2010 (Central Bank of Sri Lanka, 2010). Moreover, for the livelihood recovery of the war-affected regions, the role of the banking sector is crucial.

The crisis that prevailed in the Northern and Eastern provinces in the past three decades restricted not only the services of the banking sector, but also the customers' investments from various angles. Since the return of normalcy, the government has been focusing its attention on promoting regional equality. International financial institutions, such as, the World Bank and the Asia Development Bank, have been strengthening their network to develop short-term and long-term investments through concessional soft loans, deviating from the policy of providing development grants.

Banking service in Sri Lanka commenced with the launching of Cooperative Rural Banks in 1906. Subsequently, the Central Bank was established in 1950. Today, the Central Bank of Sri Lanka functions as a co-coordinating centre for the activities of the State as well as private banks. To initiate saving habits and rectify inflation situations, a savings bank was established under the name Ceylon Savings Bank in 1946. Following this, the Bank of Ceylon and the People's Bank were established in 1948 and 1961 respectively under the category of State commercial banks. Subsequently, many banks have been established under the names of Savings, Development and Investment with the objective of social and economic development of the country.

The Economy of the North and East

The North and East Provinces comprise of 29 percent of the total land area and 13 percent of the population of Sri Lanka. The available land and water resources and the skilled human resources of the two provinces play a major role in contributing to the national output. Due to natural and man-made disasters, the contribution of the Eastern province in 2008 was only as little as 5.5 percent while the contribution to the national product by the Northern Province was limited to a mere 2.9 percent only (Central Bank of Sri Lanka, 2010). The illegal taxes imposed by the rebel movements on production and trading and

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obstacles to inputs due to security reasons were the main reasons for the low output levels (Sarvananthan, 2008).

The frequent large-scale displacements in the North and East, heavy damages to social infrastructure, destructions to the production sectors, restrictions on service sectors, such as, education, health and banking, in addition to the restrictions imposed on inputs for reasons of security by both the warring parties resulted in the narrowing of the volume of development-related activities in these provinces. The agricultural activities of the Eastern Province which contributed 39 percent to the agriculture sector of the country had to be abandoned for many decades. In the 1980's, the contribution of North and East provinces to the total paddy cultivation was 27.8 percent, and this reduced to 24.9 percent in the year 2007 (Amarathunge, 2010).

Further, the taxes imposed on outputs, the barriers imposed on transport, marketing, etc. and other restrictions reduced the output levels of the fisheries sector manifold (Sarvananthan, 2007). These two provinces which contributed 52 percent to the

fishing industry were able to contribute only 19 percent to the output in the year 2007, especially during the period of war (Amarathunge, 2010). As the A9 highway was closed, the sea food production was marketed through the Palaly airbase. The heavy taxes imposed on these products and the increasing cost of transportation to market, caused severe hardships to both manufactures as well as consumers.

With regard to the industrial sector, Kankesanthurai cement factory and the Paranthan chemical factory in the Northern Province and the Pulmoodai ilmanite factory in the East were closed down due to prolonged conflict. This caused unemployment problems to thousands of skilled employees. In addition the resources which were available were, abandoned without utilising them. In 2004, 72 percent of the Northern economy was contributed by service sector (Sarvananthan, 2008). The high level of education made a significant contribution to this. The displacement due to security reasons was the main reason for the domestic human resource migration. These caused an impact not only on the employment-related matters, but also on education.

Following the end of the war, State organisations as well as non-governmental organisations have been focusing their attention on public infrastructure development. Large-scale basic infrastructure is being developed, connecting Arugambay, Trincomalee, Muthur and Jaffna through transport networks. Government and Non-Governmental Organisations are making a significant contribution to the recovery of the livelihood of those living below the poverty line.

The "Marshall Plan" authored by the former U.S. Secretary of State George Marshall played a significant role in the

reconstruction of the regions worst affected by World War II. This plan was implemented to reconstruct the economy of the European countries devastated by war. Under the Marshall Plan I, US \$ 1,200 crores was invested during the four-year period between 1948 and 1951 (Kelegama, 2010). Here, except for the social infrastructure development, all other recovery of the destructed livelihood was made through banks. Further, banks functioned as long-term and medium-term investors, particularly easy loans for recovery, formed the basis of short-term rehabilitation.

Organisations, such as, Grameen of Bangladesh, Israel Free Loan Association (IFLA), play a vital role in uplifting the livelihood of people. However, formation of these people-centered social network organisations within a short period seems to be impossible. Moreover, the attention of Non-Governmental Organisations on rehabilitating the medium and large-scale investors who lost their investment seems to be not satisfactory. Considering the above fact, it appears that it is possible to rehabilitate and reconstruct the entrepreneurship opportunities in the affected areas with the support of the banking sector.

The Banking Sector and the Development of the North and East

It can be said that during the period of the war, banks safeguarded the liquid assets wisely. Although regional development is one of the special obligations, the activities of banks could not be carried out in the situation of war. Due to harassment and terrorism, banks did not have adequate security. Banks were robbed. There were incidents in the North and East where bank iron safes were looted from the police stations where they were kept for safety. Fear and uncertainty were the main reasons

for banks not engaging in large-scale investments through public-private partnerships. The environment of the period was not conducive for major investments or creating fixed assets and their sustainability. Therefore, banks offered only limited primary services such as accepting savings, granting small loans and engaging in pawning services. As the rebel movement groups received information on savings, customers limited the saving activities. The people of the North and East were able neither to invest nor save with interest due to harassments.

Since the liberation of the East in 2007 and the North in 2009, the Government diverted its attention from the success at war to economic development. The Government and other international funding agencies are now implementing projects through the banking sector for the rehabilitation of the affected communities. Thus, under the program of *Mahinda Chinthanaya*, several development projects are being implemented in the North and East through "Uthuru Vasanthaya" (Northern Spring) and "Nagenahira Navodaya" (Eastern Reawakening) respectively. This aimed at increasing investment. On the other hand, assistance is offered in various ways to develop State bank networks to enhance the contribution of the banking service in the recovery of the war-affected regions.

Revival of the Banking Sector

The continuous crisis of the war in the past three decades limited the financial service outcomes at various levels in the North and East. Considering the security of the banks, the Ministry of Finance through the Central Bank of Sri Lanka has granted approval to extend limited services in the North and East provinces. People from the backward villages of Kokkadicholai, Vaharai, Karadiyanaru and Mandoor who had to travel over 40 km for their transactions are now able to receive the services at their doorstep. In

Table 1: Expansion of Licensed and Specialised Commercial Banks from 2006 to 2009 in the Northern and Eastern Provinces

District	Total Branch & Banking Outlets*			
	2006	2007	2008	2009
1 Ampara	121	172	184	192
2 Batticaloa	58	61	72	82
3 Jaffna	123	163	176	190
4 Kilinochchi	5	12	13	13
5 Mannar	14	19	22	25
6 Mulaitivu	4	10	11	11
7 Trincomalee	63	76	80	85
8 Vavuniya	22	31	33	42
Total	410	544	591	640

Note: * Includes extension offices, pawning centres, students' savings units and pay offices.

Source: Central Bank Statistics
(http://www.cbsl.gov.lk/htm/english/08_stat/s_6.html)

the year 2006, there were 450 bank branches including extension offices in the North and East. This number increased to 640 in the third quarter of 2009, showing a 56 percent growth. Further, in the first half of the year 2010, twenty new banking outlets in the North and 40 new banking outlets in the East were established. Table 1 shows the district-wise expansion of banking network.

The Bank of Ceylon increased its branches from 55 in the year 2008 to 77 in 2009. The People's Bank increased its branches from 72 to 85 and Sampath Bank from 06 to 20, during the same period. In addition, the DFCC Vardhana, National Development Bank, Pan Asia Bank, Union Bank and Lanka Puthra Bank opened two, four, two, one, two and one branch/es respectively in the year 2009. Expansion of bank branches in North and East provinces during the period 2008-2009, is shown in Table 2.

It is significant that, no overseas banks opened their branches in the North and East until 2009. However in 2010, HSBC opened its branch in Jaffna while HABIB Bank expanded its activities to the East. Further, the Central Bank of Sri Lanka opened its fourth and fifth provincial offices in the North and East respectively for better collaboration with its financial

institutions, implementation of development works and to promote financial institutions utilise available resources effectively for regional development. This is considered as another phase in the extension of banking service in the North and East regions.

Although the Ministry of Finance has intensified the opening of State and Private Banks in the North and East regions, when compared to other districts, the number of branches in proportion to the population seems limited. In the Colombo District, 658 branches are functioning on the basis of 3,831 people per branch and the Bank

Table 2: Expansion of Bank Branches in the North and East from 2008 to 2009

Name of the Bank	2008	2009
Bank of Ceylon	55	77
Commercial Bank of Ceylon PLC	09	9
Hatton National Bank PLC	16	19
People's Bank	72	85
Sampath Bank Ltd.	6	20
Seylan Bank PLC	7	7
Housing Development Finance Corporation Bank of Sri Lanka	2	2
National Savings Bank	24	26
Sanasa Development Bank	6	7
All Regional Development Banks	11	11
Total	208	263

Source: Central Bank Statistics
(http://www.cbsl.gov.lk/htm/english/08_stat/s_6.html)

Density Index remains at 26 percent. In the backward districts of Polonnaruwa and Hambantota, the Bank Density Index is 13 percent and 14 percent respectively. Table 3 also shows that banking services have not been adequately expanded in the North and East provinces in line with the population density.

Lending Programmes for Regional Development Activities

Currently, the government is providing huge amounts of funds to the people of North and East at low interest rates, through expanded bank networks. As a part of this, the Department of Regional Development was established in the East in the early part of 2008, and its service was extended to the North in mid 2009.

Under the co-ordination of this Department, investments and loans are granted for development in various sectors such as agriculture, livestock and micro, small and medium sector enterprises. Long-term loans are also provided for activities such as reconstruction of houses damaged by war and for the purchase of vehicles. Investments shown in Table 4 confirm the huge investment by this Department for

the development of North and the East regions in the year 2009.

The improved security situation since the liberation of the Eastern Province in 2008 has enhanced the finance flow in this Province. As a part of agriculture and livestock development, as announced in the budget 2008, loans amounting to Rs. 52.1 million have been provided as poverty alleviation revolving fund for the benefit of 4,732 small entrepreneurs in the year 2008. Apart from this, loans amounting to Rs.432.7 million under rural micro-credit scheme, poverty alleviation micro-credit projects, revolving trust, Susahana -II and *Krusha Navodaya* scheme, were provided for highland crop cultivation, animal husbandry, fishery, business, tourism and long-term self-employment projects. Under the revolving scheme, these investments are used as continuous investments. In addition to this, an affected individual is offered with Rs 250,000 with a six-month grace period at the interest rate of six percent. A total of Rs.423.7 million has been granted. Apart from this, 2,262 loans worth Rs.250,000 each from Revolving Trust in the year 2008 and 1,123 loans worth Rs.147 million in December 2009 were obtained for livelihood development (Central Bank of Sri Lanka, 2009). Under the Poverty Alleviation Microfinance Project (PAMP), loans amounting to Rs 175 million were granted to 27,086 small ventures through the banks up to

2009, for the benefit of small entrepreneurs in the Eastern Province.

Since the liberation of the Northern Province in May 2009, industrial sector development has been rapidly improving due to the activities of the banking sector development under the "Awakening North" program. A sum of Rs.3 billion has been allocated for providing employment for the war-affected people in the five districts of the Northern Province for the recovery in agriculture, cattle rearing, fishing, business and minor employment ventures. Under this scheme, loans to the amount of Rs.200,000 have been granted with a six-month grace period, at the concessionary interest rate of nine percent. This scheme is expected to enhance the investment, particularly the middle class. The loans granted to various sectors and the amounts since the implementation of "Awakening North" program 2009 is given in Table 5.

Under this scheme, up to the first half of 2010, 4,928 loans amounting to Rs. 676 million have been granted to middle-level investors; these loans were released with the objective of short-term recovery.

Table 3: Density as per Population

District	Population per Branch	Bank Density Index
Batticaloa	10,327	10
Trincomalee	11,152	09
Mullaitivu	35,800	03
Kilinochchi	35,800	03

Source: Central Bank Statistics
(http://www.cbsl.gov.lk/htm/english/08_stat/s_6.html)

Development of the Agriculture Sector

A total of 323,000 hectares of agriculture land was abandoned due to security reasons. Now, the Department of Agriculture is engaged in recovering the land that remained abandoned since the liberation of the North and East Provinces. According to the Department of Census and Statistics (2010), national paddy production increased by 17.5 percent and livestock production increased by 2.6 percent in 2010 due to the commencement of re-cultivation in the liberated areas of the North and East and also due to the currently prevailing situation in these districts.

Under the New Comprehensive Rural Credit Scheme, Rs. 1,943 million was released for crop cultivation in 2008/2009. Out of

Table 4: Payable Loan Schemes for the Development of Northern and Eastern Provinces in 2009

Lending Programme	Fund Allocation
Awakening North special re-finance loan scheme	Rs. 3 Billion
Revolving Fund for Development of Eastern Province "Rising East"	Rs. 1 Billion
Agro-Livestock Development Project	Rs. 5 Billion
Krusha Navodaya Scheme	Rs. 3 Billion
Poverty Alleviation Microfinance Project (Revolving Fund) 2009-2013	Rs. 3 Billion
Poverty Alleviation Microfinance Project II	JPY 2.1 Billion

Source: Central Bank of Sri Lanka, 2009.

Table 5: Funds Provided under "Awakening North" Program from July 2009 to December 2009

Sector	Fund Allocation (Rs. million)	Number of loans granted
Trade and other self-employment activities	215	1,285
Agriculture and related activities	141	1,081
Livestock development	136	1,126
Micro and small enterprises	56	496
Fisheries and related activities	36	365
Total	584	4,353

Source: Central Bank of Sri Lanka, 2009.

this, 60 percent was granted for paddy cultivation. Further, under this system, loans were granted for the cultivation of paddy and cash crops such as potatoes, onions and chilies. Facilities and opportunities were also provided to farmers to obtain loans at a low interest rate of eight percent under the *Krushinavodaya* scheme. Furthermore, the Bank of Ceylon has been promoting huge investments for the purchase of machinery for the adoption of technology in the agriculture sector with the aim of agriculture development in the East. Loans amounting to Rs. 4.7 million have been granted for the purchase of 85 paddy harvesters.

Agriculture and Livestock Development Loan scheme (ALDL) was introduced in the Budget 2008 to increase milk production. An allocation of Rs. 10 billion was made for the purchase of equipment for milk producers and farmers, and for the establishment of milk processing industries. Up to now, out of this only Rs. 70 million has been obtained as loan for a single milk production factory in the East and the balance has not been utilized yet. Managers of banks point out that the main reason for this situation is the drawback on the part of the people in preparing business plans.

The fisheries sector is the second important sector in the North East. Although, currently, there are several loan schemes for the development of the fisheries sector, medium-scale investors have obtained more benefits under these schemes. These schemes grant Rs. 250,000 for the purchase of fishing gear, out-motors, etc., at a very low interest rate of four percent, to be settled in ten instalments. Out of the recovery loans granted by banks, this is the only loan granted at the lowest interest rate. Further, the granting of loans up to Rs. 60 million to an individual for small and medium industrial development at 8.5 percent interest rate will lead to high investment. Since the end of the war, the contribution of the

regions such as Mannar and Vavuniya which are favourable for fresh water fish production has raised the national fish production by 12.2 percent in 2010 (Department of Census and Statistics, 2010).

Short-term as well as long-term loans are being granted to the worst affected tourism sector in the North and East. The Bank of Ceylon grants loans for the development of hotels with 650 beds and for the purchase of vehicles for the use of tourists in Pasikudha and Nilaveli in the East. In addition, loans are also granted for the supply of meat, eggs, vegetables, etc. and for the development of support services such as yoga and Ayurveda. While banks are assisting the Eastern Province in tourism development in various aspects, the scheme will be extended to the Northern region once landmines are cleared in the coastal areas.

Special Poverty Alleviation Scheme

With the objective of improving income level of the poor, PAMP is implemented not only in the North and East provinces, but also in certain selected districts. In this, a single family is considered as a production and consumption unit. A group of 5-10 poor families can obtain a loan up to Rs. 50,000 at eight percent interest without any surety. This loan facility contributes considerably to the improvement of living standards through poverty alleviation. Further, it forms a basis for group-wise coordinated outcome. Moreover, according to the Manager, Bank of Ceylon, Eastern Region, this loan system has been almost 100 percent successful in the North and East when compared to other loan systems. Generally, uneducated ordinary people face numerous problems in obtaining bank loans as they cannot fulfil the conditions of obtaining loans. In such a situation, the responsibility of the co-ordination group forms a

basis for granting this loan under reduced conditions.

Other Social Welfare Activities

Banks, along with other types of loans for employment initiatives in the North and East, also offer numerous loan-related support services. The Bank of Ceylon is engaged in reconstruction of houses for the people affected by tsunami. Banks have been offering loans up to Rs. 1 million at a very low interest rate of 4 percent to compensate for the loss of basic infrastructure of the middle-income group. They also provide credit on leasing of vehicles, materials, land, equipment, etc. at the interest rate of 8-12 percent, for entrepreneurship development. In addition, banks also release professional loans for educationalists at the rate of 8-13 percent interest. It is a remarkable fact that the loan released by banks increased by 39.6 percent in 2010. It was for housing, business centres, buildings, asset development, etc. that a large amount of loan has been released.

Another contemporary evolution in the services of the banking sector is the pawning service. Pawning service which was carried out on a limited scale has now been simplified and an amount very close to the price of a gold sovereign (Rs. 40,000) is offered as a loan on a competitive basis. Apart from these, banks offer free employment and life insurance to trusted customers and security and surety bonds to contractors. In addition, multifaceted welfare subsidies, such as, scholarships to the children of customers, free scholarships for overseas studies, donation for public events, etc. are also offered by banks.

Challenges and Opportunities

A healthy environment has now been created for the people and the banks to function without pressure.

At the same time, livelihood and basic infrastructure reconstruction in the North East region has been commenced as an essential service and intensified and expedited to contribute to national development. It is not an easy task within a short period of time to rebuild the severely-devastated and ruined networks that had suffered disasters simultaneously by man as well as nature continuously over the past 30 years. In this context, it is inevitable that the banking sector resort to strategies to face the following challenges to achieve the contemporary objectives which is regional development:

The customers who do not settle the loans which they obtained over the past 30 years due to destructions of war, are included in the defaulters' list and they are not eligible to obtain loans again and this has created gaps between the banks and customers. A new strategy with conditions needs to be developed to re-connect these customers. The "Highway theory" introduced by people like Mohamed Yunus offers solutions in this context.

Some of the entrepreneurs who obtained loans through banks under the war recovery scheme to engage in enterprise development were subjected to continuous natural disasters such as heavy floods in 2010/2011. They were unable to settle their loans as the appropriate insurance policy was not in force. Due to this, the liquid assets of the banks were blocked, and this caused a negative impact in the finance cycle. For disaster-prone investments, compulsory insurance plans such as those implemented by Grameen, Virac and Asha in Bangladesh need to be implemented to safeguard customers and Banks, in Sri Lanka.

Although, several new banks have opened to extend the banking activities in the North and East, there are still some challenges for short-term rehabilitation such as

finding new customers and assessing their credibility. Divisional secretaries function as the certifying authority and play a significant role in confirming the personal details of customers. Therefore, the introduction of new customers on the recommendation of Divisional Secretaries and the acceptance of the group surety will lead to create credibility of customers easily within a short period.

Customers, who have become destitute having lost all their livelihood assets, face various problems in submitting the original documents of fixed property expected for the granting of loans. As a result, customers are deprived of receiving banking services. In such a situation, it is appropriate for the banks to accept personal guarantor systems.

Though the banking sector has expanded its services to several areas, few village areas do not have access to these facilities and the people spend several hours to obtain banking services. The expansion of banking services has been proposed by people as well as the banking sector. When such services are available at the doorstep of the people, there is no doubt that banking services will strengthen. Therefore, the Central Bank of Sri Lanka and the heads of the banks should take steps for the establishment of new banks and the expansion of bank branches already established.

With the objective of enhancing the production and employment opportunities and solving investment problems, soft loans are granted to investors who provide employment to over 50 persons under the out-of-district investor promotion scheme in the North East provinces. A criticism is levelled on the inclusion of out-of-district investors that it results in negative impacts due to the exploitation of local resources and denial of employment opportunities to local residents. This problem could be solved by adopting certain

procedures such as giving priority to the investor in the affected areas, granting approval for new ventures taking into account the availability of resources and providing training for capacity development of the local workers.

While the banking sector is functioning with the concern of post-war development, providing low-interest loans will lead to livelihood recovery. It is stated that only high-interest loans are currently available for certain industry-related sectors and infrastructure development objectives. Further, it is pointed out that rigid procedures are followed by banks on interest rates and recovery methods. By introducing special co-ordinated soft loan model followed by organisations such as Israel Free Loan Association (IFLA) to reconstruct Israel from destructions, the recovery of losses and increase of investments can be simplified.

Various welfare schemes are being implemented through the banking sector in the North East by the government. It is also stated that these benefits have not reached the villagers. Seminars on banking services, advertisements on radio, television, newspaper, etc. will help develop the investment network of banks.

Banks release medium-scale and large-scale loans based on project reports. Entrepreneurs who are unable to prepare the project reports in the proper manner and get approval are unable to benefit from this loan scheme. Providing opportunities to middle-level as well as high-level entrepreneurs on awareness in designing project reports and awareness on finance, technology, marketing and management will be useful.

Organisations such as Employees' Trust Fund, North East Coastal Community Development Project (NECCDEP) Planning Office, Sri Ram Sri Lanka, BRAC Sri Lanka and YMCA take simplified micro-

credit schemes to the doorstep of the people under the small employment ventures livelihood recovery. Absence of rigid conditions, customer-centred group mechanism for the granting of loans, recovery mechanism, limited administration costs, etc. provide opportunities to obtain loans at low interest rates. This has resulted in the customers of the bank to move towards micro-credit organisations. Banks, particularly those which follow traditional banking systems, need to change from traditional policies and function with the objectives of providing easy services at the doorstep of the people to sustain their existence, which is the need of the hour.

Conclusion

Commercial banks function with two conflicting objectives of maintaining solvency and profitability. Having realised the significant contribution of the banks in the post-war development, more attention needs to be focused on the view of banks maintaining

solvency. But, State as well as private banks function with the objective of high profitability. They show hesitation in granting loans to people living under poverty line. They are interested in providing investment assistance to the elite to ensure recovery of their capital as well as profit. It is only when this situation is changed, the banking sector could contribute successfully to the post-war development of the North and the East.

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