

**NON-FORMAL CREDIT SOURCES AVAILABLE TO
SETTLERS IN THE GALNEWA AREA- A CASE STUDY**

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Non-formal financial arrangements play a significant role in the economic and social relations among the people of Sri Lanka, particularly in the rural areas. Here Upali Vidanapathirana, of the Bank's Research Department, examines the structure and potential of these non-formal credit arrangements in the Galnewa Region of the Mahaweli Project and indicates that present arrangements have not been effective in meeting the needs of the farmers.

The settlers in the Galnewa Region have now completed more than half a decade of family farm experience under new agrarian conditions. Initially, the settlers were provided with farm holdings of 3 acres (2.5 acres of irrigable land and 0.5 acres of high land) accompanied by an institutional supporting package to facilitate a smooth flow of farm operations during their early stage of re-settlement. However, in practice this formal package could not effectively absorb the frictions emanating partly from the transition of traditional subsistence forms of living to a complicated commercialized agrarian structure. Credit is one such area where the inadequacy of the formal package created a serious vacuum demanding alternative arrangements.

The objective of this study is to examine the structure and operations of the non formal credit sources in the Galnewa Region in order to ascertain their potential to cope with the present demand for credit.

A sample survey was administered towards the end of 1983, among 88 settler farmers living in the area falling within the administration block of Galnewa, for which the two stage random sampling technique was employed. The settler population of the

area in October 1983 was 2,263 families in 22 hamlets. During the first stage of sampling 11 hamlets (50%) were selected at random, from which a sample of 88 settlers (7.5%) were drawn as the second stage sample.

Socio-economic characteristics of the settlers

The settler farmers interviewed can be divided into 3 major groups, i.e. those who have been re-settled (41.6%) since or after 1975, and (b) those who have been living in the area (53.3%) prior to 1975. The former category consisted of families drawn from the neighbouring districts such as Kandy, Matale, and Kurunegala, while the latter consisted of those 'purana' villagers who had been living in the area for generations; (c) there was another residual category of migrants (5.1) who had come to the area prior to 1975.

The mean household size of the area was 5.79 which compares with the zonal figure of 5.8 given in the Consumer Finance and Socio Economic Survey of 1978/79 (Statistics Department, 1983:13). The age structure indicated a presence of a relatively young population of 33.6 percent who were below 14 years of age. The 'Family Farm' which was

confined to a 2.5 acres of irrigable land and 0.5 acres of high land provided the main income base for most of the settler farmers. However, 37 settler households interviewed (42%) were reported to have additional income sources of some kind to supplement their farm income. These sources included (a) employment in the state sector (21.5%) (b) self employment (7.9%) and finally the provision of hired labour (12.5%), which is the least lucrative of the three sources.

As many as 10 settlers have given out operational rights of part of their farm unit, under 'Ande' or 'Badu' systems. Twenty eight settlers (31.8%) who were living in the extreme end of the distributory channels, expressed their dissatisfaction over the distribution of water.

Since Family Farm operations' remained the main economic activity in the study area, the annual production and income cycle of the settlers indicated two identifiable peaks followed by corresponding lean periods. This income pattern basically corresponds with the economic activities related to the major crops, i.e. Maha 1982/83, and Yala 1983, in this study.

Table 1 below shows the total gross earnings of the settlers interviewed. Accordingly the annual gross earnings of the settlers amount to Rs. 20,185/=, with a very high variance of Rs. 11,446/=. The high variance can be explained in terms of the differential cropping intensity,

Table 1
MEAN GROSS EARNINGS OF THE SETTLERS

Source	Mean production per farmer	No. settlers reported	Farm gate price (Kg)	Total Value of production	% Value of production
Maha (4) Paddy	153 Bushels	88	2.80	8,982	44.5
Yala Paddy	49 Bushels	58	2.90	1,958	9.7
Yala Chillies	394 Bushels	42	24.70	4,643	23.0
Other sources	-	35	-	4,602	22.8
Total	-	-	-	20,185	100.0

Source: Survey Data

Table 11
ESTIMATED NET EARNINGS OF THE SETTLERS FOR THE YEAR 1982/83

Source	Gross earnings	Producer margins	Net earnings	% Net earnings
Maha (Paddy)	8,982	55.5%	4,985	36.57
Yala (Paddy)	1,958	55.5%	1,087	7.97
Yala (Chillies)	4,643	63.4%	2,956	21.68
Other sources	4,042		4,603	33.78
Total			13,631	100.00

Source: Survey Data

crop selections in Yala, actual selling prices of output and the presence/absence of off-farm economic activities as given in the table. It should also be noted that the cultivation year under reference was a relatively very successful year, during their 5-8 years of settlement experience.

The cropping pattern in Yala 1983 had basically been a combination of paddy/chillies paddy/vegetables or chillies/vegetables/pulses etc. The other sources listed in the table contain these 'residual incomes; from vegetables and pulses etc. categorised under the self-employment category (other than boutiques, retail shops etc.) along with wage incomes of those employed in the state sector, and income from the supply of wage labour.

Accordingly, as much as 66.22 percent of the total net earnings of the settler households were drawn from paddy and chillies crops cultivated in Maha 1982/83, and Yala 1983. If not

- (1) See (Karanathilake, 1978:p.2) for the background of settler families.
- (2) 'Ande' refers to share cropping while 'Badu' refers to leasing out of cultivation plot. Usually part of their full cultivation plot is given out under Badu or Ande.
- (3) See (Tilakasiri 1979:pp24.26).
- (4) Productivity figures given here deviates remarkably from those of MDB crop cutting Survey figures. This may partly be due to the conscious under valuation of paddy yields by the settlers, and partly due to the problems of lapses in memory

for the unfavourable drought conditions, prevailing in Yala 1983, which constrained the production capacities to only half of the full potential of farm holdings (under bethma), the situation would have been different.

Table 111 below shows the distribution pattern of the gross earnings of the settlers. Accordingly the earnings of not more than 21 percent of the settlers exceeded the mean gross income level of Rs. 20, 185 per annum calculated in the foregoing sessions. The very high variance of Rs.11,446/= of the income distribution pattern indicates the gravity of the problems of low income and poverty of those settlers in the lowest income brackets.

The family budget of the settler households on food (in addition to rice retained for home consumption and non food items for the month of October 1983, came upto Rs.170 per

person. Consequently an average family of 5.8 requires Rs.987/= per month, which would amount to Rs. 11,832/= per annum. It should however, be noted that the expenditure pattern in the month of October is somewhat erratic partly because the settlers were expecting incomes from their Yala crops in November, and partly because of the increased household activities in certain households due to harvesting of crops.

In this context, not more than 30 percent of the settler households were able to manage their affairs without external assistance in the form of credit or other subsidies. In other words, nearly 70 percent of the settler households suffered from the problem of 'deficit financing' of varying degrees

Dimensions of indebtedness

Of the 88 settler households interviewed 57 (64.7%) reported to be in debt, while the total outstanding debt amounted to Rs. 220,367 with a mean debt of Rs. 2,504/= per settler household. This outstanding debt was 12.4 percent of the annual gross earnings of the settler households, or 18.36 percent of the annual net earnings of These households. It should be noted that these debts were accumulated during their relatively short settlement life of 5 to 8 years, despite a substantial flow of subsidies and other monetary transfers directed to the area that came in a variety of

Table 111
DISTRIBUTION PATTERN OF THE GROSS EARNINGS OF THE SETTLER HOUSEHOLDS

Class interval	No. reported	% No. reported	Cumulative percentage
Below 7,200	4	15.9	15.9
7,201 - 14,400	31	35.2	51.1
14,401 - 21,600	25	28.4	79.5
21,600 - 28,800	05	5.7	85.2
28,801 - 36,000	07	8.0	93.2
36,001 - 43,200	02	2.2	95.4
43,000 and above	04	4.6	100.0
Total	88	100.0	100.0

Source: Survey Data

Table IV
DISTRIBUTION OF CUMULATIVE DEBT AS A PERCENTAGE OF ANNUAL GROSS EARNINGS OF THE SETTLERS

Debt % of annual gross earnings (Rs.)	Frequency	% Frequency	Cumulative % Frequency
0	31	35.3	35.3
1- 10	19	21.6	56.8
11-20	23	26.1	82.9
21-30	9	10.3	93.2
30 and above	6	6.8	100.0
Total	88	100.0	100.0

Source: *Survey Data*

forms. It is also noted that the successful crop in Maha 1982/83 would have reduced a considerable portion of these debt burdens of settler households.

The total cumulative debt of 50 settler households interviewed (56.8%) was below 10 percent of the annual earnings of settler households (Rs. 20, 185/-). Another 23 settlers (26%) reported to have their debt burden to be between 10-20 percent of their annual gross earnings. Only six settlers (6.8%) had their cumulative debt burdens to be more than 30 percent of their annual gross earnings.

It should be noted that the information presented above gives the debt situation as at a particular time and does not give a proper idea about the seasonal or cyclical changes that

Table V

FORMAL CREDIT FLOWS TO THE STUDY AREA (RURAL BANKS PEOPLE'S BANK)

	Maha 1979/80	Maha 1981/82	Maha 1982/83
No. settlers	27	31	23
%	30.68	35.18	26.13

Source: *Survey Data*

are common in a settler economy, For instance a major crop failure which is a common phenomenon in the settler economy would drastically change this situation.

The role of formal credit institutions

Three institutions, namely, the Peoples Bank, Co-operative Rural Banks and the Bank of Ceylon have their banking outlets to organize and provide formal credit facilities to the settler farmers in the study area. Of these outlets, the crop cultivation financing had become The exclusive operational responsibility of the People's Bank particularly since 1980 during which year the bank started its direct lending for crop cultivation systems. Prior to 1980, the crop cultivation financing was carried out through a few co-operative rural banking outlets.

The study revealed that 65 settlers (74%) had taken some kind of credit assistance at least once from the institutional credit sources during their settlement life. In other words, 23 settlers (26%) had never resorted to institutional credit during this period.

The settlers served by the formal credit outlets appear to vary from 26 percent to 35 percent, and it had never exceeded 45 percent except for 1977/78 Maha. A variety of explanations are given for the low coverage which was mainly due to:

- (a) those settlers who deliberately avoid formal credit due to personal reasons,
- (b) those settlers who have not taken up formal credit due to lack of awareness/acceptance,
- (c) those settlers who resorted to formal credit once, for more than once) but were disqualified later due to default resulting from economic reasons (inability to pay),
- (d) those settlers who are disqualified due to misuse of credit and/or wilful default.

The first two categories reduced credit coverage of formal sources by 26 percent, while the third

category related to default of previous loan commitments had been the major reason for the present reduced coverage of formal credit. The presence of wilful default is said to be quite marginal.

The settlers interviewed attributed a variety of reasons for the non-repayment of loans among which, crop failure, settlement of previous debt, low income, and health problems were the major ones. The living conditions and the present life styles of majority of the defaulters indicated that the three earlier reasons were closely interwoven. The non cultivation of crops for one season, or crop damage due to insufficient water, results in a low level of production. Similarly the high cost of production and non-renumerative price structure left only a limited margin for the producers own sustenance particularly during the two lean periods.

The structure and potential of non-formal credit service

Altogether 32 settler farmers interviewed, had taken non formal credit amounting to Rs. 88,609/- which was 42.2 percent of the total cumulative debt of the settlers. Of these 32 settlers, 27 (85%) had obtained both formal and non formal credit interchangedly. Only five settlers had resorted to non formal credit exclusively. Thus the borrowings from non formal sources, amounted to Rs. 1,007 per settler.

The sources of borrowings within the non formal category, appear to be numerous and most of these sources could be categorised into two major classes; asnamely commercial and non-commercial (Sande-le-

- (5) See (Statistics Department 1983:p. 128).
- (6) See (Vidanapathirana, 1984:p.23-25).
- (7) See (Karunatilake, 1978).
- (8) The total amount of credit granted by the Galnewa Branch of the People's Bank during Maha 1977/78 had shown a remarkable increase which was attributed to the relaxation of eligibility criteria for loans for Maha 1977/78.

ratne 1977:2). This classification is based on the terms and conditions on which these loans were obtained. The conventional method of classifying the sources of borrowings into friends and relatives, professional money lenders, boutique keepers, marketing agents etc. were found to be ambiguous at least in the context of diverse field conditions in the settler economy of the study area.

Unlike in a traditional village, farmer families are drawn from different areas and newly settled in a strange socio-cultural environment. The system of extended family is broken and accessibility to larger tracts of land for a variety of uses (as in the case of purana village systems) is constrained. The settlers are compelled to adopt intensive modern cultivation techniques in comparably smaller plots of land which are quite new to most of these settler groups, i.e. those in the 'purana' villages and those who were brought down from the neighbouring districts.

The intensive family farm model, envisaged in the Mahaweli programme appears to have been a drastic change from the accepted pre-settlement modes of cultivation of the majority of settlers. The imposition of the HYV package and related new technology in a new irrigation setting compelled the settlers to adhere to a strict cultivation discipline in terms of the use of water and the practice of farmers operations based on a cultivation calendar.

Initially a few settlers who had accumulated capital stock that was brought into the area in the form of compensation payments, cattle, house utensils and trainbalé man power etc. were able to adopt into the new system with a fair degree of success. (Karanathileke 1978:p.2)

Furthermore, the new system was exclusively geared to commercialised farming where money plays an important role. In contrast, the pre-

(9) See (Siriwardena 1981: p.27, 42) for a contrasting point of view.

settlement experience of a bulk of the settlers, was non-monetary and non-commercial, where the governing-force of economic activity was their very subsistence. For this, they required only 'limited' cash which was raised from the off farm operations. (MDB 1972:p. 17).

In this context, the presence of highly professional money lender operations or land lordism is yet to emerge and the continuing crop failures have not permitted the evolution of a group of rich friends and relatives or a rich farmer class as in the case of the village environment outside Mahaweli. This has led to a restricted local financial market in the settler economy. For instance, less than 30 percent of the settlers were able to reach the break-even point estimated in this study. Of this 30 percent only a handful would be in a position to help other settlers who were facing serious credit gaps. This along with the meagre credit coverage of the formal institutional sources ranging from 26-35 percent of the total settler community would alleviate only part of the total credit requirements.

This strong imbalance in the credit market, compels the settlers to treat whatever source of borrowings available to be 'friendly'. Thus the settlers could not distinguish this type (friends) from that of conventional boutique keepers, rich farmers, tractor owners, mudalalis or professional money lenders.

Even in the case of relations credit transactions appear to have taken place only among persons who were fairly close to each other. The terms and conditions of loans, vary depending on the degree of credibility which was inversely related to the 'risk element' from the point of view of the lender. On this basis commercial borrowings on non formal credit included credit accompanying an expressed or hidden interest rate. (Vidanapathirana 1984:47).

The incidence of borrowing on an expressed interest rate was relatively marginal, although this type of

borrowings was made when settlers were in acute distress due to ill health, crop damage, death of a family member etc. The interest rates are often calculated on a monthly basis that ranged from 10-25 percent per month and the sources of borrowings include those persons earning regular monthly income from state sector employment or other dependable income from trading or contracts. These sources were concerned about the monthly interest rather than the principal as it appears to be very remunerative investment.

The bulk of the commercial borrowings were made on hidden interest rates manipulated at the stage of marketing of farm inputs. It is made obligatory for borrowers to sell their produce at a price very much below the prevailing market or floor prices determined by the state. A typical example of this was that the settlers were asked to sell paddy at Rs.2/40 to Rs.2/60 per kg. to cover up loan funds at times when the market price reached a very much higher rate of Rs.3/00 to Rs.3/30 per kg. On this basis it was calculated that the settlers pay a quite exorbitant rate of interest, ranging between 60 percent per crop. Related to this was the over-valuation of loan inputs such as buffaloes/tractor days, deed paddy fertilizer etc.

Thus the hidden interest rate either takes the form of an overvaluation of loan inputs or an under valuation of settler produce both of which are associated with the production process of the settlers.

The second group of non-commercial borrowing constituted only 23 percent of the total non formal borrowing. A salient feature of this category of borrowing is that there is no interest element or the element of interest was negligible. These borrowings are often made to settle immediate-short term liquidity requirements and the commitments are settled speedily. The sources of borrowings often include very close relatives (if any) and friends.

On the whole both formal and non formal credit sources as they operate in the Galnewa area today

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